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Supreme Court of the United States

October Term, 1969

No. 1175

THE FOUNDING CHURCH OF SCIENTOLOGY,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioner, the Founding Church of Scientology, a religious corporation, prays that a writ of certiorari issue to review the judgment of the United States Court of Claims, entered July 16, 1969.

Opinion Below

The opinion of the United States Court of Claims (Appendix A, *infra*, pp. A1 to A28) is reported at 412 F. 2d 1197. The opinion of the Trial Commissioner (Appendix B, *infra*, pp. B1 to B25) is not officially reported.

Jurisdiction

The judgment of the Court of Claims was entered on July 16, 1969. A petition for amendment of judgment or for rehearing was denied on November 14, 1969.

The jurisdiction of this Court is invoked under 28 U.S.C. §1255(1).

Questions for Review

1. Does the denial of tax exemption to a particular religion constitute discrimination among religions in violation of the First Amendment?

2. Before the religion of Scientology can be denied tax exemption under Section 501(c) (3) of the Code, must there be established a marked difference between the secular practices and operations of Scientology and those of all other religions?

3. Should the burden of proof be with the Government in a case involving tax exemption of a religion?

4. Is the decision of the Court of Claims in violation of Section 503 of the Code?

5. May Scientology be disallowed exemption from tax for all four years in issue in the absence of a finding that inurement occurred during each of the four years in issue?

Constitutional Provision and Statutes Involved

First Amendment to the Constitution of the United States:

> Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peacefully to assemble, and to petition the Government for a redress of grievances.

The statutes applicable at the time were Sections 501(a), 501(c)(3) and 503 of the Internal Revenue Code of 1954. The pertinent text of these statutes is set forth in Appendix C, pp. C1 to C3.

The Facts

The Petitioner, the Founding Church of Scientology (hereinafter sometimes referred to as the "Church"), was incorporated on July 21, 1955 under the laws of the District of Columbia as a non-profit religious society and corporation. It was the first of many churches of Scientology. Scientology churches now exist throughout the United States and in many foreign countries. There are tens of thousands of adherents of the religion of Scientology throughout the United States and the world.

As with most religions, Scientology was founded and has grown and evolved from the studies, beliefs, teachings and charisma of one man, L. Ron Hubbard. The beliefs of Scientology center around the spirit or "thetan", which is said to reside within the physical body of every human being. Scientologists believe that this spirit is im-

mortal and that it receives a new body upon the death of the body in which it then resides. They also believe that in the course of its various lives the spirit is inhibited by "detrimental aberrations," or "engrams," which result from misdeeds or unpleasant experiences. The objective of Scientology is to cleanse the spirit through "processing," also called "auditing." This process, which is the principal practice of Scientology, attempts to make the person being audited, called a "preclear," aware of these aberrations and engrams and thus reduce the burdens and inhibitions affecting his spirit. Processing is performed by ministers of the church, or persons studying to become ministers, and is done in individual sessions with an auditor processing a single preclear with the aid of a Hubbard Electro-Meter[1] or "E-Meter."[2]

Scientology needs funds in order to survive and attract new adherents. Unlike the established religions, however, Scientology did not and does not have investments which generate the necessary funds for the operation of the religion. Additionally, being a new religion, Scientology could not expect to receive substantial contributions and endowments from wealthy adherents. Therefore, the funds necessary for its existence and propagation were obtained in the most equitable manner possible, namely, assessing the religion's adherents in direct proportion to the extent to which they avail themselves of the services of the church. This was done in the form of a fixed contribution

1. The E-Meter is an instrument which indicates changes in electrical resistance in the preclear's body, and changes in such resistance are viewed as an index of the activity of the spirit.

2. A2 and A3. References herein to "A" are to the opinion of the Court of Claims and its findings of fact reproduced in Appendix A hereof.

for religious services (processing) and for books containing the beliefs of the church.

As with most other religions, certain ministers and church officials receive salaries and other emoluments for their efforts on behalf of the church. L. Ron Hubbard, the Founder and moving force of Scientology, received from the Church and related organizations an annual salary and lecture fees and royalties during the four years in issue averaging a total of less than $20,000 annually and received the use of a residence and automobile during certain periods of time.[3]

In spite of what we submit are the same basic activities and compensatory practices as are engaged in, albeit sometimes in different forms, by other religions, the Government denied Scientology exemption from Federal income tax under Section 501(c) (3) of the Internal Revenue Code of 1954, as amended (hereinafter referred to as the "Code"), contending that Scientology was not being operated as a religion but as a business and that there was an inurement of earnings to the benefit of L. Ron Hubbard and his family.[4]

The Taxes in Dispute

Petitioner commenced an action in the United States Court of Claims for recovery of $631.48 in Federal income taxes paid for the fiscal year ended June 30, 1956 on the grounds that it was a religious organization exempt from

3. A8.

4. A5.

Federal income tax pursuant to Section 501(c)(3) of the Code. The Government denied that Petitioner was exempt from tax and counterclaimed for additional taxes. The Trial Commissioner of the Court of Claims denied Scientology exemption from tax on the ground that it was not being operated as a religion, but as a business. The Court of Claims declined to rule on whether Scientology was being operated as a religion or as a business and, instead, held that the Church was not entitled to exemption from Federal income tax since the Church had "failed to prove that no part of * * * [its] * * * net earnings inured to the benefit of private individuals"[5] and entered judgment for the Government in the sum of $16,043.75 plus interest for the Church's fiscal years ended June 30, 1956, 1958 and 1959 (the Church had no net income for its fiscal year ended June 30, 1957).

Reasons for Granting a Writ of Certiorari

A dangerous precedent has been created by the unconstitutional decision in this case.

If the decision of the Court of Claims is permitted to stand, Scientology will be the only religion denied exemption from Federal income tax. Although neither the Court of Claims nor the Government have challenged the fact that Scientology is a religion and that its many thousands of adherents practice and sincerely believe it to be such, the decision in this case has deprived Scientology and its adherents of the Constitutional protection against discrimination accorded all other religions.

In the deepest sense, the basic beliefs and secular practices of Scientology are markedly similar to those religions

5. A5.

whose First Amendment guarantees have never been challenged by the Government.

Scientologists believe in an immortal soul and the principal practice of the religion is to cleanse that soul. This function is chiefly performed by its duly ordained ministers, recognized and licensed as such by the various states in which the religion has established its churches.

Scientology, like other religions, has evolved from the teachings and inspiration of one man, L. Ron Hubbard, and has grown to a religion having tens of thousands of adherents.

Scientology, like all religions, requires income to pay rent, heat, light, telephone, and similar expenses. In addition, like other religions, it pays to its ministers modest salaries and to its spiritual leader, L. Ron Hubbard, has paid compensation which would seem modest indeed (an average of less than $20,000 per year for the years in question).

To our knowledge, the Government has never challenged the compensation of any other religious leader in this country. Yet, in the present case, the Government and the Court of Claims have seized upon such compensation to deny the Church of Scientology the exempt status accorded to all other religions, which it could otherwise only accomplish by declaring Scientology not to be a religion.

Moreover, the opinion of the Court of Claims applies an erroneous standard for determining whether a religion is entitled to Federal income tax exemption and does not

take cognizance of, and therefore leaves unresolved, an apparent conflict between Section 501(c)(3) and Section 503 of the Code.

Thus, this case involves more than the right of the Church of Scientology and its parishioners. It is respectfully submitted that unless this writ of certiorari is granted and the decision below reversed, a dangerously erroneous precedent will exist which will threaten the existence of any other religion which the Government, at its whim, may choose to attack.

I

The denial of tax exemption to a particular religion constitutes discrimination among religions in violation of the First Amendment.

The First Amendment affords all religions the right to exist free from Governmental discrimination and interference. Yet, Scientology is the only religion which presently does not enjoy exemption from Federal income tax and which continually is required to resort to the courts in order to engage in its religious practices.

While a new religion, if it surviyes, may ultimately be stronger for having undergone a baptism of fire as a result of being subjected to Governmental discrimination and attack, it is submitted that this type of initiation is precisely what the First Amendment is designed to prevent.

We are not contending that the Government is precluded by the First Amendment from ever challenging whether

what purports to be a religion is, in fact, a religion. Nor are we contending that the First Amendment precludes the Government from subjecting all religions to tax or from challenging a particular practice of a particular religion if it is illegal and harmful to the general public. However, we submit that the First Amendment affords absolute protection to every religion against discrimination through tax treatment different from all other religions and against subjection to continual Governmental harassment.

The Government has never directly disputed the fact that Scientology is a religion, since to do so would immediately invoke the protection afforded by the First Amendment. Instead, in every case involving Scientology, the Government fills its factual presentation with innuendoes that Scientology is something other than a religion. In response to such an indirect attack, the Court of Appeals for the District of Columbia has held:

> "Finally, we come to the vexing question: is Scientology a religion? On the record as a whole, we find that appellants have made out a *prima facie* case that the Founding Church of Scientology is a religion. It is incorporated as such in the District of Columbia. It has ministers, who are licensed as such, with legal authority to marry and to bury. Its fundamental writings contain a general account of man and his nature comparable in scope, if not in content, to those of some recognized religions. The fact that it postulates no deity in the conventional sense does not preclude its status as a religion." *Founding Church of Scientology* v. *U.S.*, 409 F.2d 1146, 1160, cert. den. —— U.S. ——.

In this case, the Court of Claims, although denying Scientology exemption from tax and declining to decide whether the Church is a religious organization, nevertheless was constrained to find that Scientology's followers do not "regard Scientology as anything less than a religion and it would appear that most practicing Scientologists sincerely believe in Scientology as a religious experience."[6]

The decisions of this Court relative to the First Amendment afford all religions, including Scientology, the following protection against governmental action: the Government may not regulate religious beliefs as such, *Cantwell* v. *Connecticut*, 310 U.S. 296, 84 L Ed 1213, 60 S Ct 900 (1940); nor penalize individuals or groups because they hold religious views abhorrent to the authorities, *Fowler* v. *Rhode Island*, 345 U.S. 67, 97 L Ed 828, 73 S Ct 526 (1953); nor coerce individuals or groups, *Abington School District* v. *Schempp*, 374 U.S. 203, 10 L Ed 2d 844, 83 S Ct 1560 (1963); *Engel* v. *Vitale*, 370 U.S. 421, 8 L Ed 2d 601, 82 S Ct 1261 (1962); nor approve or disapprove of any particular form of religious services, *Engel* v. *Vitale*, *ibid.*, nor show partiality to any one group or religion, *Torasco* v. *Watkins*, 367 U.S. 488, 6 L Ed 2d 982, 81 S Ct 1680 (1961); *Zorach* v. *Clauson*, 343 U.S. 306, 96 L Ed 954, 72 S Ct 679 (1952); *Illinois* v. *Board of Education*, 333 U.S. 203, 92 L Ed 649, 68 S Ct 461 (1948); nor discriminate invidiously between religions nor discourage any, whether the restraint be direct or indirect, *Sherbert* v. *Verner*, 374 U.S. 398, 10 L Ed 2d 965, 83 S Ct 1790 (1963); *Braunfeld* v. *Brown*, 366 U.S. 599, 6 L Ed 2d 563, 81 S Ct 1144 (1961); nor blot out a particular religious theory, *Epperson* v. *Arkansas*, 393 U.S. 97 (1968).

6. A15.

In this highly sensitive constitutional area "'[o]nly the gravest abuses, endangering paramount interests, give occasion for permissible limitation [of petitioners' First Amendment rights]; *Thomas* v. *Collins*, 323 U.S. 516, 530, 89 L Ed 430, 440, 65 S Ct 315' ", *Sherbert* v. *Verner, supra,* 374 U.S. at 406, 10 L Ed 2d at 972.

The need which a religion has for the above-described protection under the First Amendment and the reasons for such protection were eloquently described by Justice Douglas in his opinion in *United States* v. *Ballard,* 322 U.S. 78, 87, 88 L Ed 1148, 1154, as follows:

> "* * * The Fathers of the Constitution were not unaware of the varied and extreme views of religious sects, of the violence of disagreement among them, and of the lack of any one religious creed on which all men would agree. They fashioned a charter of government which envisaged the widest possible toleration of conflicting views. Man's relation to his God was made no concern of the state. He was granted the right to worship as he pleased and to answer to no man for the verity of his religious views. The religious views espoused by respondents might seem incredible, if not preposterous, to most people. But if those doctrines are subject to trial before a jury charged with finding their truth or falsity, then the same can be done with the religious beliefs of any sect. When the triers of fact undertake that task, they enter a forbidden domain. *The First Amendment does not select any one group or any one type of religion for preferred treatment. It puts them all in that position.* * * *" (emphasis supplied).

In spite of the seemingly complete protection against discrimination and Governmental interference which this

Court has continually interpreted the First Amendment as affording, Scientology is the only religion which is not exempt from tax and which, virtually from its inception, has had to seek the protection of the courts in order to engage in its religious practices.

The denial to Scientology of the protection afforded by the First Amendment is not merely a theoretical deprivation of rights but may result in the destruction of the religion.

This Court has stated that "* * * It is plain that a religious organization needs funds to remain a going concern * * *" *Murdock* v. *Pennsylvania*, 319 U.S. 105, 111, 87 L. Ed. 1292, 1297. Being denied tax exemption will result in a substantial loss of funds through payment of taxes to the Government and by the curtailment of contributions to the Church, since contributions will not be deductible.

Additionally, subsequent to the decision in this case, the Government revoked the exemption from tax of all other Scientology churches and published a notice of revocation which resulted in a communication of this fact to the general public through various media. Being the only religion denied tax exemption will connote to the general public that, somehow, Scientology is less of a religion than all other religions. This will probably mean a loss of present adherents and increased difficulty in obtaining adherents in the future.

The foregoing consequences of denial of tax exemption apparently are not sufficiently destructive to Scientology

to satisfy the Government, for this is merely one weapon in the Government's arsenal.

The Government is also attempting to confiscate the religious objects necessary to the practice of Scientology and to stop their importation. *The Founding Church of Scientology* v. *U.S.*, 409 F. 2d 1146, cert. den. —— U.S. ——; *The Church of Scientology of California* v. *Finch, et al.*, appeal pending 9th Cir., No. 24276, appeal filed March 27, 1969; *The Church of Scientology of Minnesota, et al.* v. *Department of Health, Education and Welfare, et al.*, U.S. D.C. Minn., 4th Div., Civil Action No. 4-69-Civ. 86; *The Church of Scientology of Texas, et al.* v. *Cohen*, U.S.D.C. W.D. Texas, Civil Action No. 68-45-A, February 4, 1969.

Since, in order to exist and expand Scientology must win all of the cases involving the Government, it has already been forced to devote the time of its key personnel as well as substantial sums of money to this multiple litigation. This burden will increase in the future. In addition to the foregoing cases presently pending before the courts, the denial of tax exemption to all of the Scientology churches will require each church to engage in separate litigation with the Government in order to obtain tax exemption.

We submit that a denial of tax exemption to any one religion is discriminatory and violative of the First Amendment. As heretofore described, the effects to Scientology of such denial are not only a theoretical deprivation of its constitutional rights but a severe limitation on its existence and a license to the Government to continue with its campaign to destroy Scientology.

II

Before the religion of Scientology can be denied tax exemption under Section 501(c)(3) there must be established a marked difference between the secular practices and operations of Scientology and those of all other religions.

Section 501(c)(3) of the Code grants tax exemption to certain organizations if they comply with certain general requirements. It is then left for the Government and the courts to make a subjective determination whether the general requirements of Section 501(c)(3) have been met. While this may be proper for other types of organizations, we submit that it is improper as applied to a religion.

For a religion to be afforded the protection of the First Amendment in a case involving tax exemption an objective test must be created, namely, whether the secular practices of the religion involved are markedly different from those of all other religions.

Unless such a clear objective standard is prescribed by this Court, it would be impossible for an appellate court ever to determine whether an adverse finding by a jury or a court was based upon objective facts or was partially due to a conscious or subconscious bias against the religion involved.

It is submitted, therefore, that the Court of Claims' decision in this case not only violates Scientology's First Amendment rights but creates a dangerous precedent in that a purely subjective test has been applied to determine whether a religion is entitled to tax exemption.

As to the specific issue in this case, there is no clear legal definition of what constitutes an improper inurement of earnings to an individual, although the courts have held that payment of a reasonable salary, determined by commercial standards, does not constitute an inurement of earnings. *Birmingham Business College, Inc.* v. *Commissioner*, 276 F.2d 476, 480 (5th Cir. 1960); *Enterprise Ry. Equip. Co.* v. *United States*, 142 Ct. Cl. 192, 202, 161 F. Supp. 590, 596 (Ct. Cl. 1958).

Since most religions pay salaries and provide other emoluments to their ministers and officials, the Government and either a court or a jury presently have the power to make a subjective determination whether a particular salary or other emolument is reasonable or unreasonable. While such a subjective determination may be proper in the area of corporate and individual taxation, it is improper where the result of a finding that there has been an unreasonable payment, no matter how innocent or insignificant, is to deny a religion the same crucial right to tax exemption as is enjoyed by all other religions.

We submit that the Court of Claims, in this case, has not only applied an improper test, but that as a matter of objective fact there was no inurement of earnings to L. Ron Hubbard or any one else, either *per se*, or from the viewpoint of the secular practices of Scientology as compared to other religions.

The secular practices of Scientology with respect to compensation consist of payment of salaries, reimbursement of expenses and making of occasional loans to its ministers and to officials of the church, providing certain

ministers and church officials with food and shelter and, where appropriate, automobiles. Undoubtedly, most if not all other religions engage in the same activities. Yet, Scientology is the only religion which has been denied tax exemption on account of such activities.

Specifically, during the years before the Court of Claims, namely, July 21, 1955 through June 30, 1959, L. Ron Hubbard, the Founder and guiding force of Scientology, received a salary, fees for innumerable lectures, and royalties from extensive writings, totalling $77,460.[7] This is an average yearly total compensation of about $19,375.[8] We submit that at a minimum, it is reasonable compensation for the Founder and moving force of a new religion during its formative years, who necessarily devoted all of his time and energies to the propagation of the religion. Although

7. A8.

8. As additional reasons for its finding of inurement of earnings, the Court of Claims mentioned that L. Ron Hubbard received monies from other Scientology congregations and organizations and that members of L. Ron Hubbard's family received monies from the Church. There is nothing in the record, and the Court of Claims made no findings, as to which other organizations paid L. Ron Hubbard, nor as to what amounts they paid him, much less anything to indicate such amounts were substantial. Nevertheless, the Court of Claims stated that these payments, in unknown and likely minimal amounts, indicated that the Church was not compensating L. Ron Hubbard "for full time service", and that he was running "a franchise network for private profit", which included the Church (A8 and A9). We submit that these statements are totally unsupported and improper.

It was also improper for the Court of Claims to consider income from the rental of real property and minor loans to members of the Hubbard family as constituting inurement of income in the absence of a showing that the rent paid was improper and that the loans were not repaid. However, even if the real property rented to the Church had *no value*, if the loans were never repaid, and if the salaries were entirely unjustified, the total of all of the foregoing for the the four years in issue was only $17,853 (A10). If considered as additional compensation to L. Ron Hubbard, these items would bring his total average yearly compensation to less than $24,000.

we do not have information as to the compensation paid to founders and chief officials of other religions, we strongly suspect that it equals or exceeds the compensation paid to L. Ron Hubbard.

Finally, it appears from its opinion that the Court of Claims did not consider that the fact that Scientology is a religion should have any bearing on the decision of the case. Among the numerous cases cited by the Court of Claims, in its opinion, *not one involved a religion.* Yet, there are many cases relating to a religion's right to tax exemption because of the First Amendment, such as *United States* v. *Ballard, supra; Murdock* v. *Pennsylvania, supra; Golden Rule Church Ass'n,* 41 T.C. 719 (1964); *A. A. Allen Revivals, Inc.* v. *Commissioner,* decided Oct. 11, 1963 (P-H Memo T.C., par. 63,281; *St. Germain Foundation* v. *Commissioner,* 26 T.C. 648 (1956); and *Unity School of Christianity* v. *Commissioner,* 4 B.T.A. 61 (1926) all of which were cited to the Court of Claims in Petitioner's briefs. The Court of Claims discussed none of them.

In order to reverse the Court of Claims' decision in this case it is not necessary for this Court to decide if, in fact, discrimination has occurred. The adoption by the Court of Claims of a subjective standard which has no restraints on potential discrimination is itself a violation of the First Amendment. We submit, therefore, that this Court should reverse the Court of Claims and create an objective standard for determining whether a particular religion is entitled to tax exemption, namely, whether the secular practices of the religion in question are markedly different from those of all other religions.

III

The burden of proof should be with the Government in a case involving tax exemption of a religion.

Although acknowledging that "the exemption provisions should be liberally construed"[9] the Court of Claims denied the Church exemption from tax primarily because the Church had failed to submit evidence justifying certain expenditures.[10] The situation, therefore, is that without a finding of impropriety but merely because the Court of Claims considered the Church as having and failing to meet the burden of proof on numerous minor items, Scientology is the only religion which is not exempt from tax.

It is submitted that the burden of proof must be with the Government in any case where the result would be discrimination against a religion.

The importance of who has the burden of proof is dramatically illustrated by what has transpired in this case.

The Government denied the Church exemption from tax on the ground that it was being operated as a commercial business and not as a religion and, incidentally, on the

9. A5.

10. The required evidence would have been a substantial number of vouchers, each evidencing a relatively minor expense incurred by L. Ron Hubbard and members of his family on behalf of the Church, cancelled checks or other substantiation evidencing loans or advances to the Church and expert testimony as to the rental value of real property used by the Church. Additionally, since Internal Revenue Agent Klimkiewicz spent innumerable hours auditing the Church records and prepared Joint Schedule 11 listing the expenditures in the manner claimed by the Church, it was felt that submission of the type of evidence mentioned above was unnecessary.

ground that there was inurement of earnings to certain individuals. Virtually all of the testimony before the Trial Commissioner related to the beliefs and activities of the Church. The Trial Commissioner, in his opinion, discussed the activities of the Church at length and found that the Church was being operated as a commercial business and not as a religion.[11] Because of this holding the Trial Commissioner made no finding on the question of inurement of earnings.[12]

The Government only devoted pages 70-73 of its 76 page brief in the Court of Claims to the argument that there was inurement of earnings to certain individuals. The Petitioner only devoted pages 40-42 of its 43 page main brief and pages 16 and 17 of its 22 page reply brief to this question. Similarly, virtually the entire oral argument before the Court of Claims was devoted to the question whether the Church was operating as a religion or as a business.

It is obvious, therefore, that the parties considered the question of inurement of income to be incidental in this case. Yet, the Court of Claims relied solely on that point and decided the case against the Church primarily on the ground of a lack of evidence. A subsequent motion by the Church to be permitted to present the evidence which the Court of Claims found lacking was denied.

The burden of proof on a negative, such as lack of inurement, is always heavy. Every possible argument must be answered. Every item must be justified, no matter how

11. B7.

12. B9.

trivial it may appear (*e.g.* $200.00 paid to L. Ron Hubbard's son—A10). The exigencies of tax collection are felt to justify the hardships and occasional injustices that may result from imposing such a burden on a secular taxpayer. But when applied against a religion, especially an unpopular one, such a burden of proof becomes an instrument of such oppressive power as to be repugnant to the First Amendment.

IV

The decision of the Court of Claims is in violation of the provisions of Section 503 of the Internal Revenue Code.

There is an apparent conflict between the provisions of Section 501(c) (3) and Section 503 of the Code.

Section 501(c) (3) of the Code provides that no part of the net earnings of an organization may inure to the benefit of an individual, if that organization is to be exempt from tax.

Section 503(a) (1)—(A) of the Code denies exemption to an organization described in Section 501(c) (3) if it has engaged in a "prohibited transaction." The Section 503(c) definition of "prohibited transaction" includes all of the transactions which could and would constitute inurement of earnings to an individual. Therefore, Section 501(c) (3) and Section 503 appear to be co-extensive and compatible. *However, Section 503(b) exempts a religious organization from the provisions of Section 503(a)* and, as a result, from the prohibition against engaging in a "prohibited transaction."

Thus, a religion although expressly not subject to denial of tax exemption for engaging in a "prohibited transaction" (i.e., payment of excessive salaries) by virtue of Section 503(b) still faces a potential denial of exemption under Section 501(c) (3) for the same transaction (i.e., payment of excessive salaries).

It is submitted that the only interpretation whereby the two sections do not conflict is that a religious organization can only be denied exemption from tax under Section 501(c) (3) if the sole purpose of the formation of the organization was for it to engage in prohibited transactions with the individuals who formed it. The Treasury has in its Regulations adopted this interpretation of Section 501 (c) (3) to differentiate the loss of exemption provisions of that section from those of Section 503. Reg. §1.503(a)-1(c), examples 1 and 2 provide as follows:

> "1. A creates a foundation in 1954 ostensibly for educational purposes. B, a trustee, accumulates the foundation's income from 1957 until 1959 and then uses a substantial part of this accumulated income to send A's children to college. The foundation would lose its exemption for the taxable years 1957 through 1959 and for subsequent taxable years until it regains its exempt status.
>
> "2. *If under the facts in example (1) such private benefit was the purpose of the foundation from its inception, such foundation is not exempt by reason of the general provisions of Section 501(c) (3), without regard to the provisions of Section 503,* for all years since its inception, that is, for the taxable years 1954 through 1959 and subsequent taxable years, since under Section 501(c) (3) the organization must be organized and operated exclusively for exempt purposes.

See §1.501(c) (3)-1. See also §1.504-1 for loss of exemption in the case of certain organizations accumulating income." (Emphasis supplied.)

It is submitted, therefore, that in order for exemption to be denied to the Church because of a transaction which would constitute a prohibited transaction, a court must find that the purpose of the creation of Scientology was for income to inure to the benefit of L. Ron Hubbard. The Government has never made this contention nor is there even a scintilla of evidence in the record from which a court properly could draw this conclusion.

As we have said before, it would be a violation of the First Amendment for a court or jury to be able merely to make an essentially unreviewable factual determination that an individual received as little as $1.00 in excess of what was considered to be reasonable compensation and thereby cause a religion to lose its tax exemption. The analysis we have set forth in this Point eliminates the possibility of such unconstitutional decisions and resolves the apparent conflict between Section 501(c) (3) and Section 503 of the Code.

V

It is improper for Scientology to be disallowed exemption from tax for all four years in issue in the absence of a finding that inurement occurred during each of the four years in issue.

Even if the Court of Claims' finding that there was inurement of income to L. Ron Hubbard was legally proper, the Court of Claims should be required to make such a finding for each of the years in issue in order for Scientology to be denied exemption from tax in each of such years.

It is submitted that at least for the Church's fiscal years ended June 30, 1956 and June 30, 1957, it is clear that there was no inurement of earnings to L. Ron Hubbard and or to his family.

For the Church's fiscal year ended June 30, 1956, L. Ron Hubbard received a salary of approximately $6,000.[13] For the Church's fiscal year ended June 30, 1954, L. Ron Hubbard received a salary slightly in excess of $11,500.[14] There were few, if any, emoluments received by L. Ron Hubbard or members of his family during those years; prior to March 29, 1957, L. Ron Hubbard did not receive 10% of the Church's gross income as compensation.[15]

It appears, therefore, that the Court of Claims improperly denied Scientology exemption from tax for all of the

13. A8.
14. A8.
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years in issue because of a finding by that Court that there was inurement of income during certain of the years in issue.

The effect of the Court of Claims disallowing the Church an exemption from tax for all years in issue in the absence of a finding of inurement for each of those years is to create a precedent whereby a charitable organization can be disallowed exemption for all of the years of its existence if a court happens to find inurement of income to an individual for one or more of those years. Obviously, such a result and such a precedent is improper.

Conclusion

For the reasons stated, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

Appendix A

Opinion of the United States Court of Claims

IN THE UNITED STATES COURT OF CLAIMS

No. 226-61

(Decided July 16, 1969)

THE FOUNDING CHURCH OF SCIENTOLOGY v. THE UNITED STATES

Ronald Dreier for plaintiff; *Bella L. Linden*, attorney of record. *David Blasband, Peter C. Clapman*, and *Linden & Deutsch*, of counsel.

Michael I. Sanders, with whom was *Assistant Attorney General Johnnie M. Walters*, for defendant. *Philip R. Miller* and *Norman J. Hoffman, Jr.*, of counsel.

Before COWEN, *Chief Judge*, LARAMORE, DURFEE, DAVIS, COLLINS, SKELTON, and NICHOLS, *Judges*.

OPINION*

COLLINS, *Judge*, delivered the opinion of the court:

This is a suit to recover Federal incomes taxes and assessed interest paid by plaintiff to defendant for the fiscal year ended June 30, 1956. Defendant has counterclaimed for taxes assessed but unpaid for the fiscal years ended June 30, 1956, June 30, 1958, and June 30, 1959. The central issue presented is whether plaintiff is entitled to an

* The court is indebted to Trial Commissioner Donald E. Lane (now Judge, U.S. Court of Customs and Patent Appeals) for his opinion, findings of fact, and recommended conclusion of law. Although the court reaches the same result, we decide the case on a different ground.

exemption from Federal income taxation. The pertinent statute is section 501(c)(3) of the Internal Revenue Code of 1954, which includes among those organizations exempt from taxation a corporation "organized and operated exclusively for religious * * * or educational purposes, * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual * * *."

The facts set forth in detail in the findings can be briefly summarized to the extent pertinent here:

Plaintiff is a District of Columbia corporation organized in 1955 with its purpose, as stated in the Certificate of Incorporation, "[t]o act as a parent church for the propagation of the religious faith known as 'Scientology,' and to act as a Church for the religious worship of that Faith." The beliefs of Scientology center around the spirit or "thetan," which is said to reside within the physical body of every human being. Scientologists believe that the spirit is immortal and that it receives a new body upon the death of the body in which it then resides. They also believe that in the course of its various lives the spirit is inhibited by "detrimental aberrations," or "engrams," which result from misdeeds or unpleasant experiences. The objective of Scientology is to counteract this burden through "processing," also called "auditing." This objective, which is the principal practice of Scientology, attempts to make the person being audited, called a "preclear," aware of these aberrations and engrams and thus reduce the burdens and inhibitions affecting his spirit. Processing is performed by ministers of the plaintiff, or persons studying to become ministers, and is done in indi-

vidual sessions with an auditor processing a single preclear through the use of a Hubbard Electro-Meter or "E-Meter." The E-Meter is an instrument which indicates changes in electrical resistance in the preclear's body, and changes in such resistance are viewed as an index of the activity of the spirit. (See finding 10, *infra.*)

Scientology is derived from the thoughts and writings of one L. Ron Hubbard. Its origin was an article written by Hubbard in the May 1950 issue of ASTOUNDING SCIENCE FICTION magazine, describing a new "science" called *Dianetics.* Dianetics, the creation of Hubbard, was offered primarily as a psychotherapeutic technique and was not presented as a religious discipline. Like its successor, Scientology, Dianetics employed a Hubbard E-Meter in its practice. In 1952 Hubbard began to focus his attention and his energies upon Scientology. He founded the plaintiff organization and completely dominated every aspect of its affairs during the relevant period. At the same time he continued to direct the growth and affairs of Scientology organizations throughout the world.

Persons coming to plaintiff for processing were usually required to sign a contract for a stated amount of auditing. The normal contract covered 25 hours of processing at a rate of $20 per hour. Other blocks of processing were available, and the per-hour fee was slightly lower for larger amounts. In addition to processing, another department of plaintiff offered various courses or training programs, and such instruction was also performed under contract for comparable fees. Most students enrolled in these courses were studying to become auditors and/or ministers of

Scientology. Applicants were often required to contract for processing at the standard fee before being allowed to enroll as students.

During the period in issue, more than 90 percent of plaintiff's income was received from the sales of processing and training services, including sales of E-Meters. Additional income was realized from the sales of examinations and tests, tapes, and books, from minimal donations, and from various other sources. Plaintiff's gross receipts were $102,604 for the fiscal year ending June 30, 1956; $179,491 for the fiscal year ending June 30, 1958; and $247,674 for the fiscal year ending June 30, 1959.

For his services to plaintiff, Hubbard was paid a salary of $125 per week from plaintiff's inception through March 29, 1957; during the period October 26, 1956, through March 29, 1957, he also received an additional $125 per week which was designated as a "fee." On March 29, 1957, plaintiff adopted a compensation scheme (known as the "proportional pay plan") whereby Hubbard was paid, in lieu of salary, 10 percent of the gross income of plaintiff. Other Scientology congregations, franchises, and organizations also paid Hubbard a portion of their gross income, usually 10 percent. In addition, Hubbard received royalties on his numerous Scientology books, as well as lecture fees and other incidental income.

During the taxable years in issue, Mary Sue Hubbard and L. Ron Hubbard, Jr., the wife and son of plaintiff's founder, were compensated employees of the corporation. Also, from June 1957 through February 1959, plaintiff issued weekly checks to Kay Hubbard, the daughter of L. Ron Hubbard.

Defendant's position, briefly stated, is that plaintiff fails to qualify for the statutory exemption because (1) its sales of processing and training services constituted a substantial commercial (and hence nonexempt) purpose, and (2) a portion of its net earnings inured to the benefit of private individuals. Plaintiff denies both contentions.

It is our opinion that plaintiff has failed to prove that no part of the corporation's net earnings inured to the benefit of private individuals, and plaintiff is not entitled to recover. The court finds it unnecessary to decide whether plaintiff is a religious or educational organization as alleged, since, regardless of its character, plaintiff has not met the statutory conditions for exemption from income taxation. In any event, the Government has not raised this issue. Because of the manner in which the second question framed by the parties is resolved, we need not and do not determine whether plaintiff's operations were exclusively for religious or educational purposes.

Implicit in section 501 is the recognition that certain institutions and organizations exist and function for purposes which Congress deems beneficial to society as a whole. In order to foster these aims, funds which would otherwise be acquired and expended for the public good by the Government are left by Congress in the hands of these organizations to be used in furtherance of their beneficial ends. *See Duffy* v. *Birmingham*, 190 F. 2d 738, 740 (8th Cir. 1951). For that reason, it has been held that the exemption provisions should be liberally construed. *E.g., American Institute for Economic Research* v. *United States*, 157 Ct. Cl. 548, 302 F. 2d 934 (1962), *cert. denied*, 372 U.S. 976, *rehearing denied*, 373 U.S. 954 (1963).

The statutory language also makes it eminently clear, however, that Congress intended to extend the exemption only when the sole beneficiary of the institutional operations was the public at large. The substantial import of this express limitation cannot be ignored. *See Better Business Bureau of Washington, D.C., Inc.* v. *United States,* 326 U.S. 279, 283 (1945). The congressional intent behind the conditional language of section 501(c)(3), coupled with the burden of proof placed upon the taxpayer in these circumstances (*see, e.g., Kenner* v. *Commissioner,* 318 F. 2d 632 (7th Cir. 1963); *Cleveland Chiropractic College* v. *Commissioner,* 312 F. 2d 203, 206 (8th Cir. 1963)), requires plaintiff to clearly demonstrate its right to exemption. *See New Jersey Auto. Club* v. *United States,* 149 Ct. Cl. 344, 181 F. Supp. 259 (1960), *cert. denied,* 366 U.S. 964 (1961).

The term "net earnings" in the inurement-of-benefit clause, as stated in section 501 and its predecessor, section 101 of the Internal Revenue Code of 1939, has been construed to permit an organization to incur ordinary and necessary expenditures in the course of its operations without losing its tax-exempt status. *Birmingham Business College, Inc.* v. *Commissioner,* 276 F. 2d 476 (5th Cir. 1960); *Enterprise Ry. Equip. Co.* v. *United States,* 142 Ct. Cl. 192, 161 F. Supp. 590 (1958); *Mabee Petroleum Corp.* v. *United States,* 203 F. 2d 872 (5th Cir. 1953); *Broadway Theatre League of Lynchburg, Va., Inc.* v. *United States,* 293 F. Supp. 346, 355 (W.D. Va. 1968).

By analogy to the recurrent tax question in the business sphere, whether corporate officers' salaries are reasonable and deductible, or are excessive and disguise the distribution of dividends (*see, e.g., Jones Bros. Bakery, Inc.* v.

United States, 188 Ct. Cl. —— (June 1969)), several decisions indicate that the payment of reasonable salaries by an allegedly tax-exempt organization does not result in the inurement of net earnings to the benefit of private individuals. *Birmingham Business College, Inc.* v. *Commissioner, supra* at 480; *Enterprise Ry. Equip. Co.* v. *United States, supra; Mabee Petroleum Corp.* v. *United States, supra* at 876. Of course, as the *Birmingham Business College* and *Mabee Petroleum* cases hold, excessive salaries do result in inurement of benefit. *Cf. also Duffy* v. *Birmingham, supra.* As always, whether the salaries paid are reasonable is a question of fact. *Compare, e.g., Mabee Petroleum Corp.* v. *United States, supra* at 875, *with Jones Bros. Bakery, Inc.* v. *United States, supra,* and cases cited.

It is clear, however, that an organization's net earnings may inure to the benefit of private individuals in ways other than by the actual distribution of dividends or payment of excessive salaries. *General Contractors' Ass'n* v. *United States*, 202 F. 2d 633 (7th Cir. 1953) (reports and surveys furnished to members); *Chattanooga Auto. Club* v. *Commissioner*, 182 F. 2d 551 (6th Cir. 1950) (services to members); *Underwriters' Laboratories, Inc.* v. *Commissioner*, 135 F. 2d 371 (7th Cir.), *cert. denied*, 320 U.S. 756 (1943) (reports and studies furnished); *Spokane Motorcycle Club* v. *United States*, 222 F. Supp. 151 (E.D. Wash. 1963). (goods, services, and refreshments given), and cases cited. That the benefit conveyed may be relatively small does not change the basic fact of inurement. *Spokane Motorcycle Club* v. *United States, supra.*

We scrutinize the facts of the instant case in the light of these principles. According to the trial commissioner's

findings, L. Ron Hubbard received over $108,000 from plaintiff and related Scientology sources during the 4-year period June 1955 through June 1959. This figure represents $77,460 in fees, commissions, royalties, and compensation for services, plus $13,538 in payment for expenses incurred in connection with his services, as well as a total of $17,586 in reimbursement for expenditures made in plaintiff's behalf, in repayment of loans made to plaintiff and the New York organization, and as a loan from plaintiff to Hubbard. As the commissioner found, and we agree, the precise nature of the loans and reimbursed expenditures does not appear in the record. Nor do we find any explanation for most of the expenses paid. The portion of the $77,460 actually paid by plaintiff amounted to approximately $6,000 in 1955–56, more than $11,500 in 1956–57, approximately $18,000 in 1957–58, and over $22,000 in 1958–59.

Hubbard also had the use of an automobile at plaintiff's expense. During plaintiff's taxable years ending in 1958 and 1959, the organization provided and maintained a personal residence for Hubbard and his family. Moreover, in addition to all the foregoing, Hubbard received a percentage (usually 10 percent) of the gross income of affiliated Scientology organizations.

For purposes of deciding this case, we do not consider the income accruing to Hubbard from the affiliated congregations and organizations as coming from plaintiff. However, under the circumstances here, the fact that Hubbard had income from such closely related sources indicates that Hubbard's compensation from plaintiff was not for full-time service. During the years in issue these other percentages, fees, and commissions, so far as the record shows,

were apparently received or receivable by Hubbard for his personal use. Such an arrangement suggests a franchise network for private profit and, in turn, casts doubt upon the propriety of the payments by plaintiff to Hubbard and the members of his family. The fact that Hubbard was the recipient of income from plaintiff in the form of royalties and commissions likewise occasions an inference of personal gain.

In this regard, we note the steady increase in Hubbard's compensation. Originally salaried at $125 per week, Hubbard received $250 the following year, $125 of which is described merely as a "fee." In March of 1957, Hubbard began to receive 10 percent of plaintiff's gross income. Although the organization's gross receipts in fiscal year 1957-58 were less than in fiscal year 1956-57, Hubbard's income pattern is still one of growth. Moreover, the record supports the conclusion that plaintiff and Scientology generally have consistently grown since the years in issue, while Hubbard, or his communication center in England, has continued to receive a percentage of the income of plaintiff and affiliated organizations.

When, with this general background, we consider that Hubbard, the dominant figure in Scientology, and his wife were two members of plaintiff's 3-man board of trustees during the relevant period, it is not inappropriate to require plaintiff to justify the payments made to Hubbard and his family in the nature of loans, reimbursements for expenditures in plaintiff's behalf, for expenses, and other purposes. Not only can these payments, in the absence of explanation, be properly attributable to the individuals as income (*cf. Parker* v. *Commissioner*, 365 F. 2d 792 (8th Cir.

1966), *cert. denied*, 385 U.S. 1026 (1967); *see also Kenner* v. *Commissioner*, 318 F. 2d 632 (7th Cir. 1963)), but the logical inference can be drawn that these payments were disguised and unjustified distributions of plaintiff's earnings.

In addition to the unexplained amounts received by Hubbard described above, his family received the following additional payments entirely, or almost entirely, from plaintiff:

Mary Sue Hubbard, the wife of plaintiff's founder, had income from September 1955 through December 1958 by virtue of renting property owned by her to plaintiff. Her total receipts from this venture were $10,685. Payments amounting to $1,450, attributable to the debts of her son, were made in 1956 and 1957. A completely unexplained figure of $250 and loans of $800 were received in 1958-59.

L. Ron Hubbard, Jr., was the recipient of loans in 1955-56 and 1958-59 totaling $1,226. He was reimbursed for expenditures of approximately $200 in behalf of plaintiff in 1957-58 and 1958-59.

In fiscal years 1957-58 and 1958-59, Kay Hubbard, the daughter, received payments, generally designated as salary or wages, totaling $3,242. The record is devoid of any evidence showing services performed by Miss Hubbard for plaintiff. This amount includes loans of $550 made in 1958.

What emerges from these facts is the inference that the Hubbard family was entitled to make ready personal use of the corporate earnings. *Cf. Birmingham Business College, Inc.* v. *Commissioner*, *supra* at 480. We have no evidence that the rental paid by plaintiff for Mrs. Hubbard's property was reasonable, or that such an arrangement was beneficial or desirable to the corporation. Inflated

rental prices can amount to inurement of benefit. *See Texas Trade School* v. *Commissioner*, 272 F. 2d 168 (5th Cir. 1959).

Similarly, the purpose of the loans made to the Hubbards is unexplained. We do not know whether the terms were financially advantageous to plaintiff or whether in fact the loans were ever repaid. Indeed, the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement of benefit. For comparable reasons, the proof concerning the payments for expenses and expenditures in behalf of plaintiff is also defective.

In substance, then, nothing we have found in the record dispels the substantial doubts the court entertains concerning the receipt of benefit by the Hubbards from plaintiff's net earnings. Since plaintiff has failed to meet its burden of proof, we hold therefore that a part of the corporate net earnings was a source of benefit to private individuals.

In this regard, we think it immaterial whether the benefit is viewed as inuring to Hubbard—by easing his obligation to support his family—or directly to the respective members of the family. All the Hubbards were persons "having a personal and private interest in the activities of the organization." Treas. Reg. §1.501(a)-1(c).

The extent of the seeming benefit to Hubbard's family might appear relatively small, but plaintiff has not suggested that it was *de minimis*, and we cannot so conclude from the evidence before us. It is our opinion, from an examination of the statute and the decided cases, that Congress, when conditioning the exemption upon "no part"

of the earnings being of benefit to a private individual, specifically intended that the amount or extent of benefit should not be the determining factor. *See Spokane Motorcycle Club* v. *United States, supra.*

With respect to Mr. Hubbard, plaintiff seeks to bring itself within the doctrine of the cases cited above which hold that reasonable salaries paid by a corporation do not result in inurement of benefit to private individuals. Even had the compensation paid to Hubbard been demonstrably reasonable, however, this showing would not remedy the defects in proof concerning the additional payments to Hubbard or, of course, his family. If in fact a loan or other payment in addition to salary is a disguised distribution or benefit from the net earnings, the character of the payment is not changed by the fact that the recipient's salary, if increased by the amount of the distribution or benefit, would still have been reasonable.

For all the above reasons, therefore, the court concludes that plaintiff has failed to prove its entitlement to exemption from income taxation under section 501(c)(3) of the Internal Revenue Code of 1954. Plaintiff's claim is denied, and the petition is dismissed. Defendant is entitled to prevail on its counterclaims. In accordance with the stipulation of the parties, as reflected in unchallenged findings of the commissioner, judgment is entered for defendant in the amounts of $3,262.75 for the fiscal year ending June 30, 1956, $5,399.03 for the fiscal year ending June 30, 1958, and $7,381.97 for the fiscal year ending June 30, 1959. As part of the judgment, defendant is entitled to statutory interest of 6 percent on all three sums from the respective appropriate dates.

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FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Donald E. Lane, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiff is a District of Columbia corporation organized in 1955 under the name of The Founding Church of Man's Religion, of Washington, D.C. Plaintiff's Certificate of Incorporation has since been amended to change its name to The Founding Church of Scientology.

2. Article Third of plaintiff's Certificate of Incorporation states that its purpose is "To act as a parent church for the propagation of the religious faith known as 'Scientology,' and to act as a Church for the religious worship of that Faith." In addition, the above-mentioned article sets forth in some detail the creed and basic beliefs of Scientology, and enumerates the powers and activities authorized in furtherance of its purpose. In the event of dissolution of plaintiff, the Certificate of Incorporation and the by-laws state that the board of trustees is empowered to dispose of its assets in such manner as they (or a majority of them) deem best suited to further the stated purposes of plaintiff.

3. L. Ron Hubbard was the founder of both Scientology and the plaintiff church, as well as several related organizations such as the Hubbard Association of Scientologists International, the Congress of Scientologists, and Distribution Center, Inc. (a separate corporation which sells Scientology books and equipment). Hubbard's views, writings, and instructions respecting Scientology are regarded by

plaintiff and its members, ministers, and staff as authoritative. During the pertinent period, Hubbard held various titles and offices in the plaintiff organization; he and his wife, Mary Sue Hubbard, constituted two of the three members of plaintiff's board of trustees at that time.

4. The basic belief or doctrine of Scientology is primarily concerned with the spirit of "thetan," which is believed to reside within the physical body of every human being. It is believed that the spirit is immortal and that upon the death of the physical body it receives another body. As it passes through its various lives, the spirit is often unable to reach its full potential as a spiritual being because of the "detrimental aberrations" or "engrams" which result from misdeeds or unpleasant experiences. Scientology attempts to counteract the burden of these aberrations by means of "auditing," which is also referred to as "processing." This objective, which is the principal practice of Scientology, attempts to make the person being audited, called a "preclear," aware of these aberrations and thereby reduce the burdens and inhibitions affecting the spirit. Processing is performed by ministers of the plaintiff church, or persons studying to become ministers, and is done in individual sessions with the auditor processing a single preclear through the use of a Hubbard Electro-Meter or "E-Meter." The E-Meter is described in finding 10. This instrument indicates changes in the electrical resistance in the preclear's body, and changes in such resistance are viewed as an index to the activity of the spirit.

5. In a processing session, the auditor asks the preclear various questions and notes both his answers and the E-

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Meter readings in an effort to uncover the detrimental aberrations burdening the preclear's spirit. The goal of Scientology processing is for the individual to advance through various levels of accomplishment leading to the state of "clear," and ultimately to become an "operating thetan." Upon attaining the latter state, a person has full understanding and control of himself and is believed to be able to leave his physical body at will. While processing is represented as acting solely upon the spirit, as opposed to the body, adherents of Scientology believe that physical health is also benefited thereby. Such physical improvement, though never actually promised, is often strongly implied in Scientology literature. Likewise, Scientology literature and advertising often expressed a belief that most physical ills were psychosomatic in origin and that an individual would become virtually immune upon attaining complete control of himself through Scientology. In this sense, plaintiff's literature claimed an ability to improve or eliminate a wide variety of disorders, including arthritis, cancer, thyroid malfunction, cataracts, radiation burns, and ulcers, to name just a few.

'6. Adherents of Scientology are not required to abandon any religious affiliation they might have, for a belief in Scientology is not inconsistent with a belief in any religion. This, however, does not mean that its followers regard Scientology as anything less than a religion and it would appear that most practicing Scientologists sincerely believe in Scientology as a religious experience. While ritual and ceremony do not play as significant a role in Scientology, as in most religions, plaintiff did hold Sunday services at various times during the relevant period. Several min-

isters of plaintiff are licensed by the District of Columbia to perform marriages, and ordained ministers of Scientology also performed funeral and naming ceremonies on various occasions.

7. Plaintiff through its various departments and related organizations advertised regularly in the yellow pages of the District of Columbia telephone directory under "Personality Development," "Personnel Consultants," and "Churches—Various Denominations." In addition, advertisements were placed in local newspapers. These notices customarily referred to Scientology as a means of increasing "Personal Efficiency," or the "I.Q." Three recommended methods of disseminating Scientology are set forth in a guide for auditors prepared by L. Ron Hubbard. These recommended methods are as follows:

(1) "I will talk to anyone." The newspaper advertisement states that Reverend ——— will "talk to anyone for you about anything." When calls are received and counseling requested, the minister assures the contact that the problem complained of is indeed significant, and urges him to visit the church. Upon his visit, he is made aware of the processing and literature available.

(2) "Illness researchers." A newspaper advertisement solicits polio victims (or victims of some other named disease) to volunteer for examination by a "research foundation" or a "charitable organization." Upon examination, the victim is told that there is a way (via Scientology) to improve his ability to walk or breathe or whatever. Such victims are not to be told that a *cure* would be effected.

(3) "Casualty contact." The Scientology representative pays personal calls on persons affected by accident, illness, or bereavement, using names and addresses obtained from the newspapers. After a brief visit to express his compassion and concern, the representative leaves his card and invites the subject to attend services at the church.

8. Persons desiring to be processed were required to sign a contract with plaintiff. Under the usual arrangement, the preclear would contract for a block of 25 hours of processing at a rate of $20 per hour. Other blocks of processing were recommended from time to time, with a slightly lower per-hour fee charged for larger blocks. Hubbard personally determined the rates to be charged for processing. The rates so determined were minimums, and individual Scientologists could charge more. Intensive programs were also available, such as $1,250 for a 3-week intensive course. Professional auditors in good standing received a substantial discount.

9. During the taxable years in issue, preclears who were unable to pay cash were extended credit and, on some occasions, such persons could receive processing free of charge. When credit was extended, the terms were governed by plaintiff's standard note form. These notes provided for 6 percent annual interest and a 25 percent service charge which was eliminated if the notes were paid when due. Past due notes were sometimes turned over to collection agencies. On at least one occasion plaintiff attempted unsuccessfully to discount promissory notes at a commercial bank. Plaintiff found a substantial number of such notes

to be uncollectible. Upon proper application, a preclear who was dissatisfied with his processing could receive a refund of fees paid to the plaintiff. Such refunds were not common, and were made only to persons completely severing their connections with Scientology.

10. The Hubbard E-Meter (also known as Electro-Psycho Meter or Electro-Meter), mentioned above in finding 4, is a battery-powered device for measuring changes in body resistance to electrical current. It consists of a wooden or plastic cabinet measuring about 10″x6″x2″, with several control knobs and a dial. Wires connect the instrument to two electrodes, usually small tin cans, which the preclear holds, one in each hand, during processing. The meter dial reflects changes in body resistance, but the readings are not actually quantitative due to uncontrollable variations in skin contact and current. Scientoligsts regard the E-Meter as essential to the processing operation. Accordingly, auditors were usually urged or required to purchase an E-Meter; such purchases were made through Distribution Center, Inc., at a price of approximately $125 to $144. The components and circuitry comprising an E-Meter are readily available and are not complex. The cost of manufacture during the relevant period was approximately $12.50.

11. Numerous books and pamphlets on Scientology were published and sold by plaintiff and by Distribution Center, Inc. Almost all of these were written by L. Ron Hubbard. Hubbard has also edited and written the major portion of most Scientology magazines and periodicals. Plaintiff considered these writings to be an effective means of disseminating Scientology, as well as a means of raising revenue.

Appenidx A

Other items offered for sale included tapes and records, car badges, jewelry, and photographs of L. Ron Hubbard.

12. During the years 1956-59, Scientology churches were established in New York, California, Florida, Texas, and Washington State. While plaintiff serves as the head of Scientology in the United States, all Scientology organizations throughout the world are under the leadership and guidance of L. Ron Hubbard. Under the written agreement between plaintiff and other Scientology organizations, plaintiff was to receive 25 percent of all donations received by its affiliates as well as 25 percent (10 percent in certain cases) of the tuition charges for training courses. The record indicates that such payments to plaintiff were rarely made. Several churches of Scientology other than plaintiff have at various times been declared by the Internal Revenue Service to be tax exempt under section 501(c)(3) of the Internal Revenue Code of 1954. In every such instance the District Director of Internal Revnue has since served notice of proposed revocation of the exempt status. The following table illustrates these actions.

Church of Scientology of:	Rule tax exempt:	Notice of Proposed Revocation	
		Served	To Be Effective
California	Jan. 2, 1957	Jan. 6, 1957	Jan. 2, 1957
New York	July 26, 1957	June 7, 1957	Year of inception
Michigan	July 3, 1962	Apr. 3, 1967	Jan. 1, 1962
Florida	Aug. 15, 1966	Apr. 13, 1967	

None of the other Scientology organizations and congregations in the United States have been exempted from Federal income tax liability.

13. In addition to processing, plaintiff offered various courses and training programs under the jurisdiction of the department of plaintiff known as the Academy of Scientology. Most students enrolled at the Academy were studying to become auditors and or ministers of Scientology. Students were customarily required to sign a "contract and release" covering the period of instruction. A formal certificate was issued upon completion of a course at the Academy. Some additional courses have been offered and some other courses have been modified by the Academy since 1956. The text materials used therein have been added to and modified over the same period. Applicants were frequently required to contract for processing (at a fee) before being allowed to enroll as students at the Academy. Approximately 6 to 8 weeks were required to become an auditor at basic levels of processing. L. Ron Hubbard was constantly engaged in research which often resulted in new processing techniques and obsolescence of former knowledge. When this occurred, auditors would be urged to take new courses on the new subject at a fee.

14. Scientology had its earliest origins in an article entitled *Dianetics: The Evolution of A Science* which L. Ron Hubbard published in the May 1950 issue of ASTOUNDING SCIENCE FICTION magazine. Dianetics was described in this article as "an organized science of thought" which offered a therapeutic technique for the treatment of "any and all inorganic mental and organic psychosomatic ills, with assurance of complete cure in unselected cases." The science of Dianetics soon became further developed in subsequent writings by Hubbard and others. This development was

solely scientific in nature, and religious aspects were not present. In 1952 Hubbard abandoned Dianetics as such and began to concentrate his energies on Scientology. Scientology was viewed by its followers as a science much broader than Dianetics and concerned with knowledge in general, while Dianetics dealt mainly with psychotherapy and the human mind. Nevertheless, the two were quite similar in practice. Dianetics employed an early form of the E-Meter.

15. As Scientology developed and organizations were formed, religious aspects were introduced. It appears from the record that three factors led to the adoption of this religious approach. First and perhaps most important, Scientology itself was becoming more and more involved with man as a spiritual being; hence religious implications were becoming increasingly significant to its followers. Second, it was hoped to avoid difficulties which Dianetics had encountered with various authorities, particularly those in the medical field. The New Jersey Board of Medical Examiners in 1950 or 1951 instituted proceedings against the Hubbard Dianetic Research Foundation, Inc., on charges of operating an unlicensed medical school. Third, operation as a religious organization might enable affiliates to qualify for income tax exemption.

16. Subsequent to the taxable years in issue, plaintiff instituted a commission program. Plaintiff paid to field auditors who referred individuals to it commissions based upon a percentage of the contracted processing and training fees. The commissions amounted to 10 percent of full cash payment and 6 percent of the combined and credit cash pay-

ment. A 10 percent commission was also paid on memberships. However, field auditors could be requested by plaintiff's department of accounts to collect overdue accounts upon which commissions had previously been paid.

17. During the taxable years in issue, Scientology Consultants for Industrial Efficiency, also known as Scientology Consultants, and the National Academy for American Psychology were also affiliated with plaintiff. Scientology Consultants for Industrial Efficiency was incorporated in 1956 under the laws of the District of Columbia with its designated offices in plaintiff's headquarters at 1812 19th Street, N.W., Washington, D.C. The incorporators were L. Ron Hubbard, Mary Sue Hubbard, and Richard P. Steves. Its stated purpose was to apply administrative principles derived from a study of Scientology and disseminate them to industry and business in order to improve industrial efficiency.

18. During the taxable years in issue, plaintiff's principal source of income was from the sale of processing and training services. Plaintiff's approximate gross receipts for the fiscal years ended June 30, 1956, through June 30, 1959, have been summarized as follows by defendant, and plaintiff has not objected:

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	Fiscal Year Ended			
	June 30, 1956	June 30, 1957	June 30, 1958	June 30, 1959
Processing	——	$ 53,024	$ 94,502	$ 65,962
Training	$ 95,616	135,839	69,876	56,121
Processing and training under contract	——	17,535	——	114,838
Total Processing & Training	95,616	206,398	164,378	236,921
Sales of exams, tests, fees, tapes, and books	1,777	5,013	5,938	3,867
Field Representatives —	2,215	——	——	——
Donations	1,934	3,647	2,840	——
Rentals	——	——	6,334	——
Memberships	364	660	——	6,582
Ministerial Ordination	503	392	——	——
Building Fund	——	12,500	——	——
Miscellaneous	195	600	——	304
Total Gross Receipts	102,604	229,220	179,491	247,674

19. Plaintiff's total gross receipts for the taxable periods in issue were $758,982. Its gross receipts increased from $102,604 for fiscal year ended June 30, 1956, its first year of operation, to $247,674 for fiscal year ended June 30, 1959. Gross income from processing and training was 93.2 percent, 90.1 percent, 91.6 percent, and 95.7 percent of total gross receipts for each of the 4 years; respectively. Voluntary donations were approximately 1 percent of total gross receipts during the periods in issue.

20. During the fiscal years ending June 30, 1956, 1957, 1958, and 1959, L. Ron Hubbard worked on and had responsibilities in every aspect of plaintiff's activities. In addition to his roles as instructor, minister, and researcher, he

was also the financial manager and general overseer of the affairs of plaintiff in all its various departments. From plaintiff's inception in July 1955 through March 29, 1957, L. Ron Hubbard received, pursuant to agreement, a salary of $125 per week; during the period October 26, 1956, through March 29, 1957, he also received an additional $125 per week which was designated as a "fee". During this period the other personnel on plaintiff's staff were compensated on the basis of salaries. On March 29, 1957, plaintiff instituted its "proportional pay plan." Under this plan L. Ron Hubbard received, in lieu of salary, 10 percent of the gross income of plaintiff. During the 4-year period from June 1955 through June 1959, L. Ron Hubbard received from plaintiff and other Scientology sources (see finding 3 above) at least $108,584, including fees, royalties, and compensation for services in the amount of $77,460; payment for expenses incurred in connection with his services, $13,538; reimbursements for payments made by him on behalf of taxpayer, $10,301; repayment of principal and payment on loans made by him to taxpayer and to the New York organization, $5,893; and a loan of $1,391 from the taxpayer in June 1959. These figures include $1,050 paid after the years here in issue and designated "back royalties," and $3,735 paid by the Congress of Scientologists shortly before plaintiff was incorporated. The precise nature of the loans and reimbursed expenses mentioned above does not appear in the record. Also, plaintiff provided during 1957-58 and 1958-59 a personal residence for the use of L. Ron Hubbard and his family. The household expenses of the residence were paid by plaintiff and, in

addition, plaintiff supplied an automobile for the use of Hubbard. Hubbard also received a percentage of the gross income (usually 10 percent) of the affiliated Scientology congregations, franchises, and organizations.

21. L. Ron Hubbard and his wife, Mary Sue Hubbard, resided in Washington, D.C., until 1959 when they moved to England. Since that time, Hubbard has led Scientology activities throughout the world from his headquarters at Saint Hill Manor, East Grinstead, Sussex, England. Communication between Hubbard and plaintiff has been maintained through the Hubbard Communications Office (HCO). Each Scientology organization has its local HCO. The Hubbard Communications Office—Worldwide (HCO-WW), located at Saint Hill, distributes L. Ron Hubbard's policies and technical data by means of bulletins, policy letters, and information letters. Since Hubbard moved to Saint Hill, HCO-WW has been designated as payee of L. Ron Hubbard's 10 percent share of plaintiff's gross income. L. Ron Hubbard and Mary Sue Hubbard were not called as witnesses during the trial of this case. L. Ron Hubbard, Jr., testified for defendant that he was active in Scientology during 1952-59, that he had seen very little, if any, results from Scientological processing that he would consider to be demonstrable results, and that he resigned from Scientology in 1959 for financial reasons and because he was tired of the Scientology organization and how it operated.

22. During the taxable years in issue plaintiff paid Mary Sue Hubbard a salary of $85 per week until the adoption of the proportional pay plan. Plaintiff also paid Mary Sue

Hubbard $250 per month as rental for the use of a house located at 2315 15th Street, N.W., Washington, D.C. During the taxable years in issue plaintiff paid L. Ron Hubbard, Jr., a salary of $85 per week until the adoption of the proportional pay plan. From June 1957 through February 1959, plaintiff issued weekly checks to Kay Hubbard (daughter of L. Ron Hubbard) totaling $3,242. There is no evidence in the record as to any services performed by Kay Hubbard for plaintiff during the years involved. During the 4-year period from June 1955 through June 1959, Mary Sue Hubbard received from all Scientology sources a total $29,635, including compensation for services, $15,863; rent for property owned by her and leased to plaintiff, $10,685; loan, $800; reimbursement for expenditures on behalf of plaintiff, $204; miscellaneous, $632; and payments attributable to debts of L. Ron Hubbard, Jr., $1,450. L. Ron Hubbard, Jr., received from all Scientology sources a total of $13,510, including compensation for services, $12,064; reimbursement for expenditures on behalf of plaintiff, $219; and loans, $1,226. Kay Hubbard received from all Scientology sources a total of $3,242. The precise nature of the loans and reimbursed expenses mentioned above does not appear in the record.

23. Plaintiff paid $631.48 as income tax for its fiscal year ending June 30, 1956. Pursuant to the execution of appropriate and timely waivers, plaintiff filed a timely claim for refund of this amount with interest as provided by law. Defendant issued a formal notice of disallowance of the claim on July 7, 1961. On January 12, 1962, a deficiency in

income tax in the amount of $3,262.75, including interest and penalty, was assessed against plaintiff for the fiscal year ending June 30, 1956. No part of this deficiency has been paid. On October 2, 1967, the Internal Revenue Service issued an assessment against plaintiff declaring deficiencies in income taxes, including penalties, for the fiscal year ending June 30, 1958, in the amount of $12,188.53, and for the fiscal year ending June 30, 1959, in the amount of $35,550.69. Thereafter, plaintiff, defendant, and the Internal Revenue Service agreed that the asserted deficiencies should be reduced to $5,399.03 for the fiscal year ending June 30, 1958, plus statutory interest, and $7,381.97 for the fiscal year ending June 30, 1959, plus statutory interest.

24. The parties have stipulated and agreed that (1) should judgment be rendered for defendant in this action, in addition to the amount for which defendant has previously counterclaimed, defendant shall be entitled to judgment for the additional amounts of $5,399.03 for fiscal year ending June 30, 1958, plus statutory interest, and $7,381.97 for fiscal year ending June 30, 1959, plus statutory interest, and that the additional amounts assessed as set forth in finding 23 shall be abated. The stipulation also provided that (2) should judgment be rendered for plaintiff in this action, defendant shall be entitled to no recovery for income taxes, penalties, and interest in respect of fiscal years ending June 30, 1958, and June 30, 1959, and that the entire amount assessed will be abated.

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CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the decision herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is therefore dismissed. Defendant is entitled to recover on its counterclaims and judgment is entered for defendant in the amounts of three thousand two hundred sixty-two dollars and seventy-five cents ($3,262.75) for the fiscal year ending June 30, 1956, five thousand three hundred ninety-nine dollars and three cents ($5,399.03) for the fiscal year ending June 30, 1958, and seven thousand three hundred eighty-one dollars and ninety-seven cents ($7,381.97) for the fiscal year ending June 30, 1959, with statutory interest of six percent on all three sums from the respective appropriate dates.

Appendix B

Opinion of the Trial Commissioner

IN THE UNITED STATES COURT OF CLAIMS

No. 226-61

(Filed August 7, 1968)

THE FOUNDING CHURCH OF SCIENTOLOGY
v. THE UNITED STATES

REPORT OF COMMISSIONER TO THE COURT*

Bella L. Linden, attorney of record, for plaintiff. *William H. Allen* and *Covington & Burling,* of counsel.

Michael I. Sanders, with whom was *Assistant Attorney General Mitchell Rogovin,* for defendant.

OPINION

LANE, *Commissioner:* This is a suit to recover Federal income taxes and assessed interest paid by plaintiff to defendant for the fiscal year ended June 30, 1956. Defendant has counterclaimed for taxes assessed but unpaid for fiscal years ended June 30, 1956, June 30, 1958, and June 30, 1959. The central issue presented is whether plaintiff is entitled to an exemption from Federal income taxation. The pertinent statute is 26 U.S.C. §501(c)(3), Internal Revenue Code of 1954, which includes among those organizations exempt from taxation a corporation "organized and operated exclusively for religious * * * or educational purposes, * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual * * *"

* The opinion, findings of fact, and recommended conclusion of law are submitted under the order of reference and Rule 57(a).

It is concluded that plaintiff is not entitled to recover.

Plaintiff is a District of Columbia corporation organized in 1955 with its purpose, as stated in the Certificate of Incorporation, "to act as a parent church for the propagation of a religious faith known as 'Scientology,' and to act as a Church for the religious worship of that Faith." The beliefs of Scientology center around the spirit or "thetan" which is said to reside within the physical body of every human being. Scientologists believe that the spirit is immortal and that it receives a new body upon the death of the body in which it then resides. They also believe that in the course of its various lives the spirit is inhibited by "detrimental aberrations" or "engrams" which result from misdeeds or unpleasant experiences. The objective of Scientology is to counteract this burden through "processing" also called "auditing." This objective, which is the principal practice of Scientology, attempts to make the person being audited, called a "preclear," aware of these aberrations and engrams and thus to reduce the burdens and inhibitions affecting his spirit. Processing is performed by ministers of the plaintiff or persons studying to become ministers, and is done in individual sessions with an auditor processing a single preclear through the use of a Hubbard Electro-Meter or "E-Meter." The E-Meter is an instrument which indicates changes in electrical resistance in the preclear's body, and changes in such resistance are viewed as an index of the activity of the spirit.

In a processing session, the auditor asks the preclear various questions and notes his answers and the E-Meter readings in an effort to diagnose problems affecting the

spirit. The goal of Scientology is for the individual to advance through various levels of accomplishment leading to the state of "clear," and ultimately to become an "operating thetan." Adherents of Scientology believe that such processing results in spiritual and emotional well-being by enabling the preclear to gain full understanding and control of himself. In addition, Scientologists believe that physical health is also benefited. Physical improvement, though never actually promised, is often implied in Scientology literature and advertising which express a belief that most physical ills are psychosomatic in origin and that an individual would become virtually immune upon attaining control of himself through Scientology. In this regard plaintiff's literature has claimed an ability to improve or eliminate a wide variety of disorders, including arthritis, cancer, thyroid malfunction, cataracts, radiation burns, and ulcers.

Adherents of Scientology are not required to abandon any religious affiliation they might have, for a belief in Scientology is not inconsistent with a belief in any religion. Although the practice of Scientology does not stress ritual or ceremony, plaintiff did hold Sunday services at various times during the relevant period. Ordained ministers of Scientology performed some marriage, funeral, and naming ceremonies on various occasions.

Scientology is derived from the thoughts and writings of one L. Ron Hubbard. Its earliest appearance was in an article written by Hubbard in the May 1950 issue of *Astounding Science Fiction* magazine describing a new "science" called *Dianetics*. *Dianetics*, the creation of Hub-

bard, was primarily a psychotherapy technique and was not presented as a religious discipline. Like its successor, Scientology, *Dianetics* employed a Hubbard E-Meter in its practice. In 1952 Hubbard began to focus his attention and his energies upon Scientology. As Scientology developed, religious aspects were introduced. This seemed appropriate in light of the increasing emphasis being placed upon man's spiritual being and, in addition, certain operating advantages were realized. Hubbard founded the plaintiff organization and completely dominated every aspect of its affairs during the relevant period. At the same time he continued to direct the growth and affairs of Scientology organizations throughout the world. For his services to plaintiff, Hubbard was paid a salary of $125 per week from plaintiff's inception through March 29, 1957; during the period October 26, 1956, through March 29, 1957, he also received an additional $125 per week which was designated as a "fee." On March 29, 1957, plaintiff adopted a compensation scheme whereby Hubbard was paid 10 percent of the gross income of plaintiff in lieu of salary. Other Scientology congregations, franchises, and organizations also paid Hubbard a portion of their gross income, usually 10 percent. In addition to the above sums, Hubbard received royalties on his numerous Scientology books plus lecture fees and other incidental income.

In order to attract the public to its organization, plaintiff advertised regularly in the local newspapers and in the yellow pages of the telephone directory. Its newspaper advertisements normally presented Scientology as a means of enhancing "Personal Efficiency" or increasing the "I.Q."

of the individual. In the telephone directory yellow pages, plaintiff's listing was placed under "Personality Development" and "Personnel Consultants" as well as under "Churches—Various Denominations." Other dissemination techniques stressed the use of Scientology for counseling or mitigation of the effects of disease.

Persons coming to plaintiff for processing were usually required to sign a contract for a stated amount of processing. The normal contract covered 25 hours of processing at a rate of $20 per hour. Other blocks of processing were available, and the per-hour fee was slightly lower for larger amounts. In addition to processing, another department of plaintiff offered various courses or training programs, and such instruction was also performed under contract for comparable fees. Most students enrolled in these courses were studying to become auditors and/or ministers of Scientology. Applicants were often required to contract for processing at the standard fee before being allowed to enroll as students.

When a preclear was unable to pay cash for his processing, plaintiff would on occasion provide this service free of charge. More often, however, credit would be extended to the preclear who would sign a note bearing 6 percent annual interest and a 25 percent service charge (which was waived if the note was paid when due). A number of these notes proved to be uncollectible. When this occurred, plaintiff sometimes turned the notes over to a collection agency. On at least one occasion plaintiff attempted unsuccessfully to discount a promissory note at a commercial bank.

Defendant's position, briefly stated, is that plaintiff fails to qualify for the statutory exemption because (1) its sales

of processing and training services constituted a substantial commercial (and hence nonexempt) purpose, and (2) a portion of its net earnings inured to the benefit of Hubbard, a private individual. Plaintiff denied both contentions, claiming (1) that its processing and training activities were substantially related to its religious purpose and hence beyond judicial inquiry and (2) that its payments to Hubbard represented reasonable compensation for his services.

This court considered a similar problem in *Scripture Press Foundation* v. *United States*, 152 Ct. Cl. 463, 285 F. 2d 800 (1961), *cert. denied*, 368 U.S. 985 (1962). The taxpayer there was a religious publishing house which claimed exemption on grounds that it was operated exclusively for religious or educational purposes. From the evidence there it appeared that the taxpayer's dominant motive was indeed to improve the Protestant Sunday schools of America, and that all of its sales of religious literature were designed to carry out this purpose. However, this court held that the taxpayer's dominant activity was sales, and its instructional activity was incidental thereto, pointing out the great disparity between its net income from sales and its expenditures for religious education purposes.

Similarly, in *American Institute for Economic Research* v. *United States*, 157 Ct. Cl. 548, 302 F. 2d 934 (1962), *cert. denied*, 372 U.S. 976 (1963), this court denied tax exempt status to an organization which performed research on economic problems and presented its findings in the form of periodicals. As in *Scripture Press Foundation, supra*, the crucial factor was the presence of a commercial purpose

which was found to be a primary purpose of the organization.

Analyzing the present case in light of the foregoing, the plaintiff here is not entitled to exemption from tax. By advertising and promoting its processing and training services in the same manner as would a commercial enterprise offering the same services, the plaintiff engaged in a trade or business. Inasmuch as plaintiff derived over 90 percent of its income during the relevant period from the sale of these services, this commercial activity cannot be viewed as anything less than a substantial purpose of the plaintiff. Since plaintiff is not operated exclusively for religious or educational purposes, it is not entitled to exemption. *Better Business Bureau* v. *United States*, 326 U.S. 279, 283 (1945).

Plaintiff contends that its processing and training activities are so closely interwoven with its religious beliefs and objectives that the Constitution of the United States, Amendment I, forbids any inquiry into these practices. Instead, this argument continues, the inquiry must be limited to a determination of whether the proceeds are applied to the organization's stated purpose. *Trinidad* v. *Sagrada Orden,* 263 U.S. 578 (1929), is cited as authority for this proposition. That case involved a Philippine missionary organization which derived a small portion of its income from the sale of wine, chocolate, and other articles. The court allowed the exemption despite this seemingly commercial activity, explaining its decision as follows:

> As respects the transactions in wine, chocolate and other articles, we think they do not amount to engaging in trade in any proper sense of the term. It is not claimed that there is any selling to the public or in

competition with others. The articles are merely bought and supplied for use within the plaintiff's own organization and agencies, some of them for strictly religious use and the others for uses which are purely incidental to the work which the plaintiff is carrying on. That the transactions yield some profit is in the circumstances a negligible factor. Financial gain is not the end to which they are directed.

While plaintiff's reliance on *Trinidad* is not wholly misplaced, it seems clear that this case involves a different situation indeed. Here we have an organization realizing virtually all of its income from an activity which it conscientiously promotes (through advertising and direct solicitation) among the general public in competition with others; such a situation is not analogous to the limited trading engaged in by the taxpayer in *Trinidad*.

There can be little doubt that plaintiff's processing and training activities are advertised and promoted as services having value over and above their purely religious and spiritual aspects. In the yellow pages of the telephone directory, plaintiff advertised under "Personality Development" and "Personnel Consultants," thus placing itself in direct competition with other businesses listed there. In its newspaper advertisement plaintiff held itself out as a means of increasing "Personal Efficiency" and the "I.Q." As this court said in *American Institute for Economic Research, supra,* "This * * * purpose to provide such information and service as would be desired by the public places plaintiff in competition with other commercial organizations providing similar services. Plaintiff has chosen to compete in this manner and, as a consequence, plaintiff's activities

acquire a commercial hue." 157 Ct. Cl. at 556, 302 F.2d at 938.

Further evidence of a commercial purpose is found in plaintiff's pricing policy with respect to the Hubbard E-Meter. This device is essential to the practice of Scientology, and every auditor was expected to acquire one for his own use. During the relevant period, the cost of manufacturing an E-Meter was approximately $12.50, while the selling price was approximately $125 to $144. Such profitability, while not at all conclusive, is indicative of a commercial operation. See *Scripture Press Foundation, supra,* 152 Ct. Cl. at 468, 285 F.2d at 803.

In denying plaintiff's recovery here, it is not necessary to reach the question of whether plaintiff fulfills the statutory requirement of a religious purpose. It is enough that a substantial nonreligious or commercial purpose was present. Likewise, this court does not reach the question of inurement of income to private individuals. Plaintiff's alternative argument, that it qualifies for exemption as an educational organization, is subject to the same defects as its principal argument based upon religious grounds.

It is recommended that plaintiff's petition be dismissed and judgment be rendered for defendant on its counterclaims.

Findings of Fact

1. Plaintiff is a District of Columbia corporation organized in 1955 under the name of The Founding Church of Man's Religion, of Washington, D.C. Plaintiff's Certificate of Incorporation has since been amended to change its name to The Founding Church of Scientology.

2. Article Third of the plaintiff's Certificate of Incorporation states that its purpose is "To act as a parent church for the propagation of the religious faith known as 'Scientology,' and to act as a Church for the religious worship of that Faith." In addition, the above-mentioned article sets forth in some detail the creed and basic beliefs of Scientology, and enumerates the powers and activities authorized in furtherance of its purpose. In the event of dissolution of plaintiff, the Certificate of Incorporation and the by-laws state that the board of trustees is empowered to dispose of its assets in such manner as they (or a majority of them) deem best suited to further the stated purpose of plaintiff.

3. L. Ron Hubbard was the founder of both Scientology and the plaintiff church, as well as several related organizations such as the Hubbard Association of Scientologists International, the Congress of Scientologists, and Distribution Center, Inc. (a separate corporation which sells Scientology books and equipment). Hubbard's views, writings, and instructions respecting Scientology are regarded by plaintiff and its members, ministers, and staff as authoritative. During the pertinent period, Hubbard held various titles and offices in the plaintiff organization; he and his wife, Mary Sue Hubbard, constituted two of the three members of plaintiff's board of trustees at that period.

4. The basic belief or doctrine of Scientology is primarily concerned with the spirit or "thetan" which is believed to reside within the physical body of every human being. It is believed that the spirit is immortal and that upon the death of the physical body it receives another

body. As it passes through its various lives, the spirit is often unable to reach its full potential as a spiritual being because of the "detrimental aberrations" or "engrams" which result from misdeeds or unpleasant experiences. Scientology attempts to counteract the burden of these aberrations by means of "auditing" which is also referred to as "processing." This objective, which is the principal practice of Scientology, attempts to make the person being audited, called a "preclear," aware of these aberrations and thereby to reduce the burdens and inhibitions affecting the spirit. Processing is performed by auditors of the plaintiff church or persons studying to become ministers, and is done in individual sessions with the auditor processing a single preclear through the use of a Hubbard Electro-Meter or "E-Meter." The E-Meter is described in finding 10. This instrument indicates changes in the electrical resistance in the preclear's body, and changes in such resistance are viewed as an index of the activity of the spirit.

5. In a processing session, the auditor asks the preclear various questions and notes both his answers and the E-Meter readings in an effort to uncover the detrimental aberrations burdening the preclear's spirit. The goal of Scientology processing is for the individual to advance through various levels of accomplishment leading to the state of "clear," and ultimately to become an "operating thetan." Upon attaining the latter state, a person has full understanding and control of himself and is believed to be able to leave his physical body at will. While processing is represented as acting solely upon the spirit, as opposed to the body, adherents of Scientology believe that physical

health is also benefited thereby. Such physical improvement, though never actually promised, is often implied in Scientology literature. Likewise, Scientology literature and advertising often expressed a belief that most physical ills were psychosomatic in origin and that an individual would become virtually immune upon attaining complete control of himself through Scientology. Plaintiff's literature claimed an ability to improve or eliminate a wide variety of disorders in this manner, including arthritis, cancer, thyroid malfunction, cataracts, radiation burns, and ulcers, to name just a few.

6. Adherents of Scientology are not required to abandon any religious affiliation they might have, for a belief in Scientology is not inconsistent with a belief in any religion: This, however, does not mean that its followers regard Scientology as anything less than a religion and it would appear that most practicing Scientologists sincerely believe in Scientology as a religious experience. While ritual and ceremony do not play as significant a role in Scientology, as in most religions, plaintiff did hold Sunday services at various times during the relevant period. Several ministers of plaintiff are licensed by the District of Columbia to perform marriages, and ordained ministers of Scientology also performed funeral and naming ceremonies on various occasions.

7. Plaintiff through its various departments and related organizations advertised regularly in the yellow pages of the District of Columbia telephone directory under "Personality Development," "Personnel Consultants", and "Churches—Various Denominations." In addition,

advertisements were placed in local newspapers. These notices customarily referred to Scientology as a means of increasing "Personal Efficiency," or the "I.Q." Three recommended methods of disseminating Scientology are set forth in a guide for auditors prepared by L. Ron Hubbard. These recommended methods are as follows:

(1) "I will talk to anyone." The newspaper advertisement states that Reverend ——— will "talk to anyone for you about anything." When calls are received and counseling requested, the minister assures the contact that the problem complained of is indeed significant, and urges him to visit the church. Upon his visit, he is made aware of the processing and literature available.

(2) "Illness researchers." A newspaper advertisement solicits polio victims (or victims of some other named disease) to volunteer for examination by a "research foundation" or a "charitable organization." Upon examination, the victim is told that there is a way (via Scientology) to improve his ability to walk or breathe or whatever. Such victims are not to be told that a *cure* would be effected.

(3) "Casualty contact." The Scientology representative pays personal calls on persons affected by accident, illness, or bereavement, using names and addresses obtained from the newspapers. After a brief visit to express his compassion and concern, the representative leaves his card and invites the subject to attend services at the church.

8. Persons desiring to be processed were required to sign a contract with plaintiff. Under the usual arrangement, the preclear would contract for a block of 25 hours of

processing at a rate of $20 per hour. Other blocks of processing were recommended from time to time, with a slightly lower per-hour fee charged for larger blocks. Hubbard personally determined the rates to be charged for processing. The rates so determined were minimums, and individual Scientologists could charge more. Intensive programs were also available, such as $1,250 for a 3-week intensive course. Professional auditors in good standing received a substantial discount.

9. During the taxable years in issue, preclears who were unable to pay cash were extended credit and on some occasions, such persons could receive processing free of charge. When credit was extended, the terms were governed by plaintiff's standard note form. These notes provided for 6 percent annual interest and a 25 percent service charge which was eliminated if the notes were paid when due. Past due notes were sometimes turned over to collection agencies. On at least one occasion plaintiff attempted unsuccessfully to discount promissory notes at a commercial bank. Plaintiff found a substantial number of such notes to be uncollectible. Upon proper application, a preclear who is dissatisfied with his processing may receive a refund of fees paid to the plaintiff. Such refunds were not common, and were made only to persons completely severing their connections with Scientology.

10. The Hubbard E-Meter (also known as Electro-Psycho Meter or Electro-Meter), mentioned above in finding 4, is a battery-powered device for measuringg changes in body resistance to electrical current. It consists of a

wooden or plastic cabinet measuring about 10″x6″x2″, with several control knobs and a dial. Wires connect the instrument to two electrodes, usually small tin cans, which the preclear holds, one in each hand during processing. The meter dial reflects changes in body resistance, but the readings are not actually quantitative due to uncontrollable variations in skin contact and current.—Scientologists regard the E-Meter as essential to the processing operation. Accordingly, auditors were usually urged or required to purchase an E-Meter; such purchases were made through Distribution Center, Inc., at a price of approximately $125 to $144. The components and circuitry comprising an E-Meter are readily available and are not complex. The cost of manufacture during the relevant period was approximately $12.50.

11. On January 4, 1963, the United States instituted an action in the United States District Court for the District of Columbia, seeking seizure and condemnation of the Hubbard Electro-Meter pursuant to 21 U.S.C. 334, on grounds that it was a device misbranded in commerce within the meaning of 21 U.S.C. 352. On the same day, pursuant to court order, the United States marshal seized various articles on the premises of the plaintiff, including a quantity of Electro-Meters, plus copies of various books and other publications which were used by the plaintiff in its processing and training activities and sold to the public during the taxable years in issue. Trial was held April 3-19, 1967. Upon jury verdict for the Government, a decree of condemnation was filed in the above-mentioned court on June 29,

1967. The court then ordered that the United States marshal destroy the seized devices together with the seized copies of publications and written matter. An appeal has been noted in this case and is now pending. (D.C. Cir. No. 21,483.) The judgment of the District Court has been stayed pending appeal.

12. Numerous books and pamphlets on Scientology were published and sold by plaintiff and by Distribution Center, Inc. Almost all of these were written by L. Ron Hubbard. Hubbard has also edited and written the major portion of most Scientology magazines and periodicals. Plaintiff considered these writings to be an effective means of disseminating Scientology, as well as a means of raising revenue. Other items offered for sale included tapes and records, car badges, jewelry, and photographs of L. Ron Hubbard.

13. During the years 1956-1959, Scientology churches were established in New York, California, Florida, Texas, and Washington State. At this same time individual Scientologists were active as private practitioners of Scientology in various other areas. While plaintiff serves as the head of Scientology in the United States, all Scientology organizations throughout the world are under the leadership and guidance of L. Ron Hubbard. Under the written agreement between plaintiff and other Scientology organizations, plaintiff was to receive 25 percent of all donations received by its affiliates as well as 25 percent (10 percent in certain cases) of the tuition charges for training courses. The record indicates that such payments to plaintiff were rarely made. Several churches of Scientology other than plaintiff

have at various times been declared by the Internal Revenue Service to be tax exempt under Section 501(c)(3) of the Internal Revenue Code of 1954. In every such instance the District Director of Internal Revenue has since served notice of proposed revocation of the exempt status. The following table illustrates these actions.

Church of Scientology of:	Rule tax exempt:	Notice of Proposed Revocation	
		Served	To Be Effective
California	Jan. 2, 1957	Jan. 6, 1957	Jan. 2, 1957
New York	July 26, 1957	June 7, 1957	Year of inception
Michigan	July 3, 1962	Apr. 3, 1967	Jan. 1, 1962
Florida	Aug. 15, 1966	Apr. 13, 1967	

None of the other Scientology organizations and congregations in the United States have been exempted from Federal income tax liability.

14. In addition to processing, plaintiff offered various courses and training programs under the jurisdiction of the department of plaintiff known as the Academy of Scientology. Most students enrolled at the Academy were studying to become auditors and/or ministers of Scientology. Students were customarily required to sign a "contract and release" covering the period of instruction. A formal certificate was issued upon completion of a course at the Academy. Some additional courses have been offered and some other courses have been modified by the Academy since 1956. The text materials used therein have been added to and modified over the same period. Applicants were frequently required to contract for processing (at a fee) be-

fore being allowed to enroll as students at the Academy. Approximately 6 to 8 weeks were required to become an auditor at basic levels of processing. L. Ron Hubbard was constantly engaged in research which often resulted in new processing techniques and obsolescence of former knowledge. When this occurred, auditors would be urged to take new courses on the new subject at a fee.

15. Scientology had its earliest origins in an article entitled *Dianetics: The Evolution of A Science* which L. Ron Hubbard published in the May 1950 issue of *Astounding Science Fiction* magazine. *Dianetics* was described in this article as "an organized science of thought" which offered a therapeutic technique for the treatment of "any and all inorganic mental and organic psychosomatic ills, with assurance of complete cure in unselected cases." The science of *Dianetics* soon became further developed in subsequent writings by Hubbard and others. This development was solely scientific in nature, and religious aspects were not present. In 1952 Hubbard abandoned *Dianetics* as such and began to concentrate his energies on Scientology. Scientology was viewed by its followers as a science much broader than *Dianetics* and concerned with knowledge in general, while *Dianetics* dealt mainly with psychotherapy and the human mind. Nevertheless, the two were quite similar in practice. *Dianetics* employed an early form of the E-Meter.

16. As Scientology developed and organizations were formed, religious aspects were introduced. It appears from the record that three factors led to the adoption of this re-

ligious approach. First and perhaps most important, Scientology itself was becoming more and more involved with man as a spiritual being; hence religious implications were becoming increasingly significant to its followers. Second, it was hoped to avoid difficulties which *Dianetics* had encountered with various authorities, particularly those in the medical field. The New Jersey Board of Medical Examiners in 1950 or 1951 instituted proceedings against the Hubbard Dianetic Research Foundation, Inc., on charges of operating an unlicensed medical school. Third, operation as a religious organization might enable affiliates to qualify for income tax exemption.

17. Subsequent to the taxable years in issue, the plaintiff instituted a commission program. Plaintiff paid to field auditors who referred individuals to it commissions based upon a percentage of the contracted processing and training fees. The commissions amounted to 10 percent of full cash payment and 6 percent of the combined and credit cash payment. A 10 percent commission was also paid on memberships. However, field auditors could be requested by plaintiff's department of accounts to collect overdue accounts upon which commissions had previously been paid.

18. During the taxable years in issue, Scientology Consultants for Industrial Efficiency, also known as Scientology Consultants, and the National Academy for American Psychology were also affiliated with plaintiff. Scientology Consultants for Industrial Efficiency was incorporated in 1956 under the laws of the District of Columbia with its designated offices in plaintiff's headquarters at 1812 19th Street,

N.W., Washington, D.C. The incorporators were L. Ron Hubbard, Mary Sue Hubbard, and Richard P. Steves. Its stated purpose was to apply administrative principles derived from a study of Scientology and disseminate them to industry and business in order to improve industrial efficiency.

19. During the taxable years in issue, plaintiff's principal source of income was from the sale of processing and training services. Plaintiff's approximate gross receipts for the fiscal years ended June 30, 1956, through June 30, 1959, have been summarized as follows by defendant, and plaintiff has not objected:

	Fiscal Year Ended			
	June 30, 1956	June 30, 1957	June 30, 1958	June 30, 1959
Processing	—	$ 53,024	$ 94,502	$ 65,962
Training	$ 95,616	135,839	69,876	56,121
Processing and training under contract	—	17,535	—	114,838
Total Processing & Training	95,616	206,398	164,378	236,921
Sales of exams, tests, fees, tapes, and books	1,777	5,013	5,938	3,867
Field Representatives	2,215	—	—	—
Donations	1,934	3,647	2,840	—
Rentals	—	—	6,334	—
Memberships	364	660	—	6,582
Ministerial Ordination	503	392	—	—
Building Fund	—	12,500	—	—
Miscellaneous	195	600	—	304
Total Gross Receipts	102,604	229,220	179,491	247,674

20. Plaintiff's total gross receipts for the taxable periods in issue were $758,982. Its gross receipts increased from $102,604 for fiscal year ended June 30, 1956, its first year of operation, to $247,674 for fiscal year ended June 30, 1959. Gross income from processing and training was 93.2 percent, 90.1 percent, 91.6 percent, and 95.7 percent of total gross receipts for each of the taxable years in issue, respectively. Voluntary donations were approximately 1 percent of total gross receipts during the periods in issue.

21. During the fiscal years ending June 30, 1956, 1957, 1958, and 1959, L. Ron Hubbard worked on and had responsibilities in every aspect of plaintiff's activities. In addition to his roles as instructor, minister, and researcher, he was also the financial manager and general overseer of the affairs of plaintiff in all its various departments. From plaintiff's inception in July of 1955 through March 29, 1957, L. Ron Hubbard received, pursuant to agreement, a salary of $125 per week; during the period October 26, 1956, through March 29, 1957, he also received an additional $125 per week which was designated as a "fee." During this period the other personnel on plaintiff's staff were compensated on the basis of salaries. On March 29, 1957, plaintiff instituted its "proportional pay plan." Under this plan L. Ron Hubbard received, in lieu of salary, 10 percent of the gross income of plaintiff. During the 4-year period from June 1955 through June 1959, L. Ron Hubbard received from plaintiff and other Scientology sources at least $108,584, including fees, royalties, and compensation for services in the amount of $77,460; payment for expenses incurred in connection with his services, $13,538; reim-

bursements for payments made by him on behalf of taxpayer, $10,301; repayment of principal and payment on loans made by him to taxpayer and to the New York organization, $5,893; and a loan of $1,391 from the taxpayer in June 1959. These figures include $1,050 paid after the years here in issue and designated "back royalties," and $3,735 paid by the Congress of Scientologists shortly before plaintiff was incorporated. The precise nature of the loans and reimbursed expenses mentioned above does not appear in the record. Also, plaintiff provided at different times two personal residences for the use of L. Ron Hubbard and his family. The household expenses of these residences were paid by the plaintiff, and in addition, plaintiff supplied an automobile for the use of Hubbard. Hubbard also received a percentage of the gross income (usually 10 percent) of the affiliated Scientology congregations, franchises, and organizations.

22. L. Ron Hubbard and his wife, Mary Sue Hubbard, resided in Washington, D.C. until 1959 when they moved to England. Since that time, Hubbard has led Scientology activities throughout the world from his headquarters at Saint Hill Manor, East Grinstead, Sussex, England. Communication between Hubbard and plaintiff has been maintained through the Hubbard Communications Office (HCO). Each Scientology organization has its local HCO. The Hubbard Communications Office—Worldwide (HCO-WW), located at Saint Hill, distributes L. Ron Hubbard's policies and technical data by means of bulletins, policy letters, and information letters. Since Hubbard moved to Saint Hill, HCO-WW has been designated as payee of L. Ron Hub-

bard's 10 percent share of plaintiff's gross income. L. Ron Hubbard and Mary Sue Hubbard were not called as witnesses during the trial of this case. L. Ron Hubbard, Jr., testified for defendant that he was active in Scientology during 1952-1959, that he had seen very little, if any, results from Scientological processing that he would consider to be demonstrable results, and that he resigned from Scientology in 1959 for financial reasons and because he was tired of the Scientology organization and how it operated.

23. During the taxable years in issue plaintiff paid Mary Sue Hubbard a salary of $85 per week until the adoption of the proportional pay plan. Plaintiff also paid Mary Sue Hubbard $250 per month as rental for the use of a house located at 2315 15th Street, N.W., Washington, D.C. During the taxable years in issue plaintiff paid L. Ron Hubbard, Jr. a salary of $85 per week until the adoption of the proportional pay plan. From June 1957 through February 1959, plaintiff issued weekly checks to Kay Hubbard (daughter of L. Ron Hubbard) totaling $3,242. There is no evidence in the record as to any services performed by Kay Hubbard for plaintiff during the years involved. During the 4-year period from June 1955 through June 1959, Mary Sue Hubbard received from all Scientology sources a total of $29,635, including compensation for services, $15,863; rent for property owned by her and leased to plaintiff, $10,685; loan, $800; reimbursement for expenditures on behalf of plaintiff, $204; miscellaneous $632; and payments attributable to debts of L. Ron Hubbard, Jr., $1,450. L. Ron Hubbard, Jr. received from all Scientology sources a total of $13,510, including compensation for services, $12,-

064; reimbursement for expenditures on behalf of plaintiff, $219; and loans, $1,226. Kay Hubbard received from all Scientology sources a total of $3,242. The precise nature of the loans and reimbursed expenses mentioned above does not appear in the record.

24. Plaintiff paid $631.48 as income tax for its fiscal year ending June 30, 1956. Pursuant to the execution of appropriate and timely waivers, plaintiff filed a timely claim for refund of this amount with interest as provided by law. Defendant issued a formal notice of disallowance of the claim on July 7, 1961. On January 12, 1962, a deficiency in income tax in the amount of $3,262.75, including interest and penalty, was assessed against plaintiff for the fiscal year ending June 30, 1956. No part of this deficiency has been paid. On October 2, 1967, the Internal Revenue Service issued an assessment against plaintiff declaring deficiencies in income taxes, including penalties, for fiscal year ending June 30, 1958, in the amount of $12,188.53, and for fiscal year ending June 30, 1959, in the amount of $35,550.69. Thereafter, plaintiff, defendant, and the Internal Revenue Service agreed that the asserted deficiencies should be reduced to $5,399.03 for the fiscal year ending June 30, 1958, plus statutory interest, and $7,381.97 for the fiscal year ending June 30, 1959, plus statutory interest.

25. The parties have stipulated and agreed that, should judgment be rendered for defendant in this action, in addition to the amount for which defendant has previously counterclaimed, defendant shall be entitled to judgment for the additional amounts of $5,399.03 for fiscal year ending

June 30, 1958, plus statutory interest, and $7,381.97 for fiscal year ending June 30, 1959, plus statutory interest, and that the additional amounts assessed as set forth in finding 24 shall be abated. Should judgment be rendered for plaintiff in this action, the parties have stipulated and agreed that the defendant shall be entitled to no recovery for income taxes, penalties, and interest in respect of fiscal years ending June 30, 1958, and June 30, 1959, and that the entire amount assessed will be abated.

Recommended Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition is, therefore, dismissed. Defendant is entitled to recover on its counterclaims in the amounts of $3,262.75 for the fiscal year ending June 30, 1956, $5,399.03 for the fiscal year ending June 30, 1958, and $7,381.97 for the fiscal year ending June 30, 1959, plus statutory interest.

Appendix C

Statutes Involved

The statutes applicable at the time were Sections 501(a), 501(c)(3) and 503 of the Internal Revenue Code of 1954. The pertinent provisions of those sections are as follows:

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

(a) Exemption From Taxation.—An organization described in subsection (c) * * * shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503 and 504.

* * *

(c) List of Exempt Organizations.—The following organizations are referred to in subsection (a):

* * *

(3) Corporations * * * organized and operated exclusively for religious, * * * purposes, * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual, * * *.

* * *

SEC. 503. REQUIREMENTS FOR EXEMPTION.

(a) Denial of Exemption to Organizations Engaged in Prohibited Actions.—

(1) General Rule.—

(A) An organization described in section 501 (c)(3) which is subject to the provisions of this section shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after July 1, 1950.

* * *

(b) Organizations to Which Section Applies.—This section shall apply to any organization described in section 501(c)(3) * * * except—

(1) a religious organization (other than a trust):

* * *

(c) Prohibited Transactions.—For purposes of this section, the term "prohibited transaction" means any transaction in which an organization subject to the provisions of this section—

(1) lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to;

(2) pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

(3) makes any part of its services available on a preferential basis to;

(4) makes any substantial purchase of securities or any other property, for more than adequate consideration in money or money's worth, from;

(5) sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or

(6) engages in any other transaction which results in a substantial diversion of its income or corpus to;

the creator of such organization (if a trust); a person who has made a substantial contribution to such organization; a member of the family (as defined in section 267(c)(4))

of an individual who is the creator of such trust or who has made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

SUPREME COURT, U. S.

FILED

MAR 13 1970

JOHN F. DAVIS, CLERK

No. 1175

In the Supreme Court of the United States

OCTOBER TERM, 1969

THE FOUNDING CHURCH OF SCIENTOLOGY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Claims (Pet. App. A1–A28) is reported at 412 F. 2d 1197. The opinion of the trial commissioner (Pet. App. B1–B25) is not officially reported.

JURISDICTION

The judgment of the Court of Claims was entered on July 16, 1969. A petition for amendment of judgment or for rehearing was denied on November 14, 1969. The petition for a writ of certiorari was filed on February 12, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether the Court of Claims correctly held that petitioner, a religious corporation, was not entitled to its claimed tax exemption because part of its net earnings inured to the personal benefit of its chief officer and founder and his family, within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

> SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.
>
> (a) *Exemption From Taxation.*—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504.
>
> * * * * *
>
> (c) *List of Exempt Organizations.*—The following organizations are referred to in subsection (a):
>
> * * * * *
>
> (3) Corporations * * * organized and operated exclusively for religious * * * purposes, * * * no part of the net earnings of which inures to the benefit of any private * * * individual * * *.

STATEMENT

Petitioner is a District of Columbia corporation which was organized in 1955. Its certificate of incorporation states that its purpose is "To act as a parent

church for the propagation of the religious faith known as 'Scientology,' and to act as a Church for the religious worship of that Faith." L. Ron Hubbard was the founder of both Scientology and the petitioner church, as well as several related organizations, such as the Hubbard Association of Scientologists International (HASI), the Congress of Scientologists, and Distribution Center, Inc. (DCI), a separate corporation which sells Scientology books and equipment. (Pet. App. A13.) During the fiscal years in question, which are those ending June 30, 1956, through June 30, 1959 (Pet. App. A1), Hubbard held various titles and offices in the petitioner organization; he and his wife, Mary Sue Hubbard, were two of the three members of petitioner's board of trustees (Pet. App. A14).

Scientology's basic belief is that the immortal spirit of "thetan" resides within the physical body of every human being, and that upon the death of the physical body it receives another body. The principal practice of Scientology is the use of a procedure to make persons aware of "detrimental aberrations" or "engrams" which result from misdeeds and unpleasant experiences and hinder the spirit from reaching its full potential. This "processing," also called "auditing," is performed by ministers of the petitioner, or students studying to become ministers, and is done in individual sessions in which the auditor processes a single individual, known as a "preclear," through the use of a Hubbard Electro-Meter or "E-Meter." (Pet. App. A14.)

Followers of Scientology regard it as a religion, and apparently most practicing Scientologists sincerely believe in Scientology as a religious experience. Several ministers of petitioner are licensed by the District of Columbia to perform marriages, and ordained ministers of Scientology also sometimes conduct funeral and naming ceremonies. (Pet. App. A15–A16.)

During the period here involved, persons desiring to be processed were required to sign a contract with the petitioner. Under the usual arrangement, they would agree to 25 hours at a cost of $20 per hour. L. Ron Hubbard personally determined the minimum amounts to be charged. Persons who were unable to pay cash were extended credit and, on some occasions, such persons were not charged at all. When credit was extended, the terms were governed by petitioner's standard note form. These notes provided for 6 percent annual interest and a 25 percent service charge, which was eliminated if the notes were paid when due. On at least one occasion petitioner attempted unsuccessfully to discount such promissory notes at a commercial bank. (Pet. App. A17.)

Petitioner published numerous books on Scientology, almost all written by L. Ron Hubbard, for the purpose of disseminating Scientology as well as raising revenue. It also sold other items, such as tapes, records, car badges, jewelry, and photographs of L. Ron Hubbard. (Pet. App. A18–A19.)

Petitioner also offered training courses, at a fee, for persons studying to become auditors or ministers

of Scientology. L. Ron Hubbard was constantly engaged in research, and auditors were urged to take new courses, at a fee, to learn new processing techniques. (Pet. App. A20.)

Scientology Consultants for Industrial Efficiency was also affiliated with petitioner. It was incorporated by three persons, including L. Ron Hubbard and his wife. Its stated purpose was the application of administrative principles derived from a study of Scientology and their dissemination to industry and business in order to improve industrial efficiency. (Pet. App. A22.)

Petitioner's total gross receipts for the taxable years in issue were $758,989. Its gross receipts increased from $102,604 for the fiscal year ended June 30, 1956, its first year of operation, to $247,674 for the fiscal year ended June 30, 1959. Gross income from processing and training exceeded 90 percent of total gross receipts for each of these 4 years; voluntary donations approximated 1 percent of total gross receipts during these years. (Pet. App. A23.)

During these 4 fiscal years, L. Ron Hubbard worked on and had responsibilities in every aspect of petitioner's activities. In addition to his roles as instructor, minister, and researcher, he was also the financial manager and general overseer of all of petitioner's various departments. From petitioner's inception in July, 1955, through March 29, 1957, L. Ron Hubbard received, pursuant to agreement, a salary of $125 per week; during the period October 26, 1956, through March 29, 1957, he also received an additional $125

per week which was designated as a "fee." During this period the other personnel on petitioner's staff were compensated by salary. On March 29, 1957, petitioner instituted its "proportional pay plan," under which L. Ron Hubbard received, in lieu of salary, 10 percent of the gross income of petitioner. (Pet. App. A23–A24.)

During the 4-year period from June 1955 through June 1959, L. Ron Hubbard received from petitioner, HASI, the Congress of Scientologists and DCI [1] at least $108,584, including fees, royalties, and compensation for services of $77,460; payment for expenses incurred in connection with his services of $13,538; reimbursements for payments made by him on behalf of petitioner of $10,301; repayment of principal and payment on loans made by him to petitioner and to the New York organization of $5,893; and a loan of $1,391 from the petitioner in June 1959. These figures include $1,050 paid after the years here in issue and designated "back royalties," and $3,735 paid by the Congress of Scientologists shortly before petitioner was incorporated. The precise nature of the loans and reimbursed expenses mentioned above does not appear in the record. Also, petitioner provided during 1957–1958 and 1958–1959 a personal residence for the use of L. Ron Hubbard and his family. The household expenses of the residence were paid by petitioner and, in addition, petitioner supplied an automobile for the

[1] During the taxable years in issue the functions of the Congress of Scientologists and DCI were carried out by petitioner's employees on its premises (Tr. 333–334). Some of the functions of HASI were carried out by petitioner (Tr. 208).

use of Hubbard. Hubbard also received a percentage of the gross income (usually 10 percent) of the affiliated Scientology congregations, franchises, and organizations. (Pet. App. A23–A25.)

During the taxable years in issue petitioner paid Mary Sue Hubbard, the wife of L. Ron Hubbard, a salary of $85 per week until the adoption of the proportional pay plan. Petitioner also paid Mary Sue Hubbard $250 per month as rental for the use of a house located at 2315 15th Street, N.W., Washington, D.C. During the same years petitioner paid L. Ron Hubbard, Jr., a salary of $85 per week until the adoption of the proportional pay plan. From June 1957 through February 1959, petitioner issued weekly checks to Kay Hubbard (daughter of L. Ron Hubbard) totaling $3,242. There is no evidence in the record as to any services performed by Kay Hubbard for petitioner during those years. During the taxable years in issue, Mary Sue Hubbard received from all Scientology sources $29,635, including compensation for services, $15,863; rent for property owned by her and leased to petitioner, $10,685; loan, $800; reimbursement for expenditures on behalf of petitioner, $204; miscellaneous, $632; and payments attributable to debts of L. Ron Hubbard, Jr., $1,450. L. Ron Hubbard, Jr., received from all Scientology sources $13,510, including compensation for services $12,064; reimbursement for expenditures on behalf of petitioner, $219; and loans, $1,226. Kay Hubbard received from all Scientology sources a total of $3,242. (Pet. App. A25–A26.)

ARGUMENT

1. The Court of Claims correctly denied a tax exemption to petitioner because of its finding that a part of petitioner's net earnings inured to the personal benefit of L. Ron Hubbard and his family. That finding is based on substantial evidence. The applicable statutory provisions, *supra,* p. 2, explicitly provide that the exemption for a religious corporation does not apply if a part of its net earnings inures to the benefit of any private individual.

The court found that L. Ron Hubbard received $108,584 in fees, royalties, and compensation for services from petitioner and its three related organizations in the 4-year period in issue, plus the use of a personal residence and an automobile (Pet. App. A24–A25). Hubbard rendered only part-time service to petitioner.[2] During this period, his wife received $29,635 from such organizations, his daughter $3,242, and his son $13,510 (Pet. App. A26). In addition, L. Ron Hubbard received a share (usually 10 percent) of the gross income of affiliated Scientology congregations, franchises and organizations (Pet. App. A25).

[2] As petitioner notes (Pet. 16, n. 8), the court below did not find the amounts of time which L. Ron Hubbard devoted to and the money received from the related (HASI, DCI and the Congress of Scientologists) and affiliated Scientology congregations, franchises, and organizations (Pet. App. A25). Petitioner does not deny that Hubbard devoted time to these organizations and that he received payments from them. The court's conclusion that Hubbard's service to petitioner was part-time was therefore correct and is a factor evidencing private inurement. See *Mabee Petroleum Corp.* v. *United States*, 44 A.F.T.R. 1034 (N.D. Tex.), affirmed, 203 F. 2d 872, 875–876 (C.A. 5).

The court below found that loans and reimbursed expenditures paid to Hubbard of $17,586 (Pet. App. A8), to his wife of $13,185 (Pet. App. A10), to his son of $1,426 (Pet. App. A10) and to his daughter of $3,242, were largely unexplained. The court properly concluded that these payments were "disguised and unjustified distributions of [petitioner's] earnings" to individuals (Pet. App. A10). The fact that L. Ron Hubbard received a fixed 10 percent share of petitioner's gross income (Pet. App. A24), plus 10 percent of the gross income of its affiliated corporations (Pet. App. A25), is strong evidence that the benefits received were more like private gain from a commercial enterprise than reasonable compensation for services rendered to a religious organization In the 4-year period in issue, Hubbard's total compensation steadily rose along with the gross income of petitioner (Pet. App. A9), although there is no evidence that he increased his services to it. Under the agreement between petitioner and Hubbard, as petitioner's gross income increased, payments to Hubbard would increase without regard to services rendered. This constituted inurement to him within the meaning of Section 501(c)(3). See *Gemological Institute of America* v. *Commissioner,* 17 T.C. 1604, 1609–1610, affirmed *per curiam,* 212 F. 2d 205 (C.A. 9); *Gemological Institute of America* v. *Riddell,* 149 F. Supp. 128, 130–131 (S.D. Calif.); *Kemper Military School* v. *Crutchley,* 274 Fed. 125, 127 (W.D. Mo.); Rev. Rul. 66–104, 1966–1 Cum. Bull. 135; Rev. Rul. 69–279, 1969–1 Cum. Bull. 152; cf. *Birmingham*

Business College, Inc. v. *Commissioner*, 276 F. 2d 476, 480–481 (C.A. 5).

The court also found private inurement through an analysis like that regularly used by courts to determine the reasonableness of compensation to business officials under Section 162 of the Code (Pet. App. A6–A7). See *Enterprise Railway Equipment Co.* v. *United States*, 161 F. Supp. 590, 596 (Ct. Cl.). Petitioner, relying on the First Amendment, suggests that the test of inurement should instead be "whether the secular practices of the religion involved are markedly different from those of all other religions" (Pet. 14). But such a test does not reflect the plain meaning of the private individual inurement provision of Section 501(c)(3), and would not carry out the statute's intent. Moreover, petitioner does not state why its proposed special test for religious organizations would in fact be more "objective" than the usual individual inurement test used in the proceeding below.[3] Indeed, the court's careful consideration of Hubbard's steadily rising income and petitioner's unexplained loans, reimbursements and rental payments to him and his family (Pet. App. A8–A12) amply indicates the court's objectivity in the circumstances of this case.

2. Petitioner's other contentions are similarly without merit. Its argument (Pet. 20–22) that the explicit provisions in Section 503 of the Code concerning certain types of prohibited transactions preclude the ap-

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[3] Petitioner itself cites with approval (Pet. 17) several cases in which courts have applied the individual inurement test to religious organizations.

plication of the private individual inurement standard of Section 501(c)(3) to religious corporations would unwarrantably deny the latter provision its plain meaning. This argument was considered and rejected in *Kenner* v. *Commissioner,* 318 F. 2d 632, 635–636 (C.A. 7). Moreover, the Committee Reports accompanying the predecessor of Section 503 [4] indicate Section 503 does not foreclose use of a disqualifying activity for denying exemption under Section 501. H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 124–125 (1950–2 Cum. Bull. 380, 469–470); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 123–124 (1950–2 Cum. Bull. 483, 571). Section 1.503(a)-1(a) of the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) reflects this congressional purpose. It provides that "The prohibited transactions enumerated in Section 503(c) are in addition to and not in limitation of the restrictions contained in section 501(c)(3) * * *."

Nor, as petitioner further contends (Pet. 21), need there be a "purpose" to engage in "private benefit" in order to effect the interdicted inurement. The examples from the regulation quoted by petitioner (Pet. 21) are not concerned with a situation involving actual inurement, as in the instant case.

Petitioner's contention that the burden of proof to show private inurement should be on the government (Pet. 18–20) is contrary to the very nature and purpose of Section 501(c)(3). The exemption from tax is made in recognition of the benefit which the public

[4] Section 3813, added to the 1939 Code by the Revenue Act of 1950, c. 994, 64 Stat. 906, Section 331.

derives from the activities of religious, charitable and educational organizations, and "is intended to aid them when not conducted for private gain." *Trinidad* v. *Sagrada Orden,* 263 U.S. 578, 581; see *Washington Ethical Society* v. *District of Columbia,* 249 F. 2d 127, 129 (C.A.D.C.). It is based on the theory that "the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare." H. Rep. No. 1860, 75th Cong., 3d Sess., p. 19 (1939–1 Cum. Bull. (Part 2) 728, 742).[5] Engagement in religious activities does not *ipso facto* confer immunity from all financial burdens of government, including income taxes. *Follett* v. *McCormick,* 321 U.S. 573, 578; *Murdock* v. *Pennsylvania,* 319 U.S. 105, 112. And since tax exemption is a matter of legislative grace, petitioner has the burden of clearly establishing a right to it. See *Dickinson* v. *United States,* 346 U.S. 389, 395, referring to the ministerial exemption from military service.

Congress' clear intent was to exempt from tax only those corporations whose purposes and activities are directed to the public at large, and it cannot be doubted that it was within Congress' power to deny the exemption where the taxpayer could not show that its activities are exclusively devoted to the public rather than to private purposes. See *Better Business Bureau* v. *United States,* 326 U.S. 279, 282–283. As a

[5] This Committee Report accompanied the Revenue Act of 1938, c. 289, 52 Stat. 447.

practical matter, it would be impossible for the government to bear the burden of proving improper private inurement. It is the taxpayer who chooses the method and scope of its records. Here those records did not show the nature or purpose of several of petitioner's payments to Hubbard or his wife and family (Pet. App. A9–A11). Petitioner cannot utilize its failure to keep full and accurate records to obtain tax-exempt status. See *Cleveland Chiropractic College* v. *Commissioner*, 312 F. 2d 203 (C.A. 8). Moreover, neither L. Ron Hubbard, his wife nor his daughter, the persons who received the payments and were most likely to know their purpose, testified in the trial of the case.[6] The facts were peculiarly within their personal knowledge, and the petitioner's failure to call them illustrates the propriety of placing the burden of proof as to the expenditures on the petitioner.

Petitioner notes that the court below did not make findings of individual inurement with respect to each of the four years in issue and urges that for the fiscal year ended June 30, 1956, there was no such inurement (Pet. 23–24). The only major elements of inurement which were not present in that fiscal year were Hubbard's 10 percent proportional pay plan and his $125 per week "fee" (Pet. App. A24). For example, petitioner's payments of $85 per week to Hubbard's son, its payments of several kinds to his daughter, and its rental payments of $250 per month

[6] L. Ron Hubbard, Jr., testified on behalf of the government (Tr. 327).

to his wife for property of undisclosed value, all took place during fiscal 1955–1956 (Pet. App. A25–A26). Section 501(c)(3) provides that "no part" of the net earnings may inure to the benefit of any individual. The mere fact that in later years petitioner diverted larger sums to individuals cannot save its exemption in the earlier year when a smaller amount was diverted. Fiscal 1955–1956 was petitioner's first year and its earnings were smallest in that year, so there were fewer total funds to divert. But the diversions of funds to private individuals were sufficient to disqualify the corporation from the exemption. See *Spokane Motorcycle Club* v. *United States*, 222 F. Supp. 151, 153–154 (E.D. Wash.).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Supreme Court of the United States

October Term, 1969

No. 1175

THE FOUNDING CHURCH OF SCIENTOLOGY,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

REPLY BRIEF OF PETITIONER

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REPLY BRIEF OF PETITIONER

Introductory Statement

Pursuant to Rule 24(4) of this Court, the Founding Church of Scientology submits this Reply Brief to the Brief for the United States in Opposition.

Argument

The Government's attitude, as reflected in its Brief, confirms our contention that the present decision of the Court of Claims establishes a precedent whereby any religion can be subjected to a discriminatory loss of tax

exemption in violation of the First Amendment, as has happened to Scientology in this case.

The Government's Brief gives no credence to, and makes very little mention of, our arguments that the First Amendment requires that all religions be afforded the same exemption from tax or, at a minimum, that before a particular religion can be denied exemption from tax the Government must bear the burden of proving that the secular activities of such religion are markedly different from those of all other religions.

Instead, the Government contends that tax exemption for each religion is an act of "legislative grace" (Resp. Br. p. 12). From that premise the Government further argues that the subjective tests for entitlement to tax exemption, such as inurement of earnings, which are applicable to secular organizations, are equally applicable and can properly be applied to religions. This would be done, as with secular organizations, on a case by case basis.

Since the tests for tax exemption are subjective and since the Government in the first instance must initiate action against a particular religion, the Government's interpretation of the law would provide it with an effective technique of discrimination among religions through selective denials of tax exemption. We submit that such an interpretation violates the First Amendment.

In addition to an erroneous overall position with respect to the legal issues of this case, we submit that the Government has made the following specific erroneous statements and contentions in its Brief:

1. At the outset of its argument, the Government states that "The Court found that L. Ron Hubbard received $108,584 in fees, royalties and compensation for services * * *" (Resp. Br. 8). In fact, the Court found that the fees, royalties and compensation for services which L. Ron Hubbard received totaled $77,460, with the balance of $31,124 being payment of and reimbursement for expenses, repayment of principal on loans and minor royalties (Pet. App. A24-A25).

2. The Government states that "Hubbard rendered only part-time service to Petitioner" (Resp. Br. 8). As support for this statement, the Government contends that "Petitioner does not deny that Hubbard devoted time to these organizations and that he received payments from them" (Resp. Br. 8, n. 2). In fact, Petitioner does deny that L. Ron Hubbard only rendered part-time service to Petitioner and has challenged a similar erroneous conclusion by the Court of Claims by stating "We submit that these statements are totally unsupported and improper" (Pet. 16, n. 8).

3. The Government relies on the 10% payments to L. Ron Hubbard to repeat once again its innuendo that Scientology is a commercial enterprise (Resp. Br. 9). As we have already stated at length, the amounts paid to L. Ron Hubbard constituted reasonable compensation for his efforts (Pet. 16).

4. The Government concedes that "The Court also found private inurement through an analysis like that regularly used by courts to determine the reasonableness of compensation to business officials * * *" (Resp. Br. 10).

The Government contends that such a criterion, which every year produces a substantial number of litigated cases and diverse decisions by the courts, is the proper criterion to apply in determining whether a religion should be afforded tax exemption.

We submit that the First Amendment requires that an objective standard be established to determine whether there has been an inurement of earnings so as to deny tax exemption to a religion. We suggest that the objective standard be whether the secular practices of the religion involved are markedly different from those of all other religions.

If such an objective standard were to be required by this Court, the Government could compile and publish the information as to the secular practices of all religions, i.e., the methods of compensating the leaders, ministers and their families and the amounts of such compensation; the policy with respect to reimbursement of expenses; the making and repayment of loans, the furnishing of food, shelter and other emoluments; and any other secular practices which are deemed relevant. With this type of information available a Trial Court could objectively determine whether a particular religion's secular practices are such as to justify a finding of inurement of earnings to an individual. An Appellate Court reviewing an adverse determination could then readily determine whether there has been discrimination against a particular religion contrary to the First Amendment.

5. The Government's argument that it should not have the burden of proof in this area because the facts are

peculiarly within the possession of the taxpayer (Resp. Br. 13) ignores the methods of discovery and compulsion of testimony which are available to the Government. It is without merit.

Conclusion

A Petition for a Writ of Certiorari should be granted for the reasons stated in the Petition for Certiorari and in this Reply Brief.

Respectfully submitted,

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